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Resolving the Conflict Between Section 10(b) and the Express Remedies of the Securities Acts: The Need for an Internally Consistent Approach to Implication

RESOLVING THE CONFLICT BETWEEN SECTION 10(b) AND THE EXPRESS REMEDIES OF THE SECURITIES ACTS: THE NEED FOR AN INTERNALLY CONSISTENT APPROACH TO IMPLICATION

Section 10(b) of the Securities Exchange Act of 1934 ('34 Act)[1] and Securities Exchange Commission (SEC) rule 10b-5[2] prohibit the use of manipulative or deceptive devices in connection with the purchase or sale of a security. Although section 10(b) does not provide expressly for a private right of action, courts consistently have granted private plaintiffs a cause of action under the statute.[3] Because section 10(b) covers the broad area of fraud, it often applies to conduct which also might be actionable under the express remedy provisions of the Securities Act of 1933 ('33 Act) or the '34 Act.[4] The Supreme Court has declined to determine whether a party may assert an implied private right of action under section 10(b) when the alleged illegal acts of the defendant might

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[1] 15 U.S.C. § 78j(b) (1976). Section 10(b) of the Securities Exchange Act of 1934 ('34 Act) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[2] 17 C.F.R. § 240.10b-5 (1980). Rule 10b-5, promulgated under § 10(b) of the '34 Act, *see* note 1 *supra*, by the Securities Exchange Commission (SEC) provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
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> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
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> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purpose or sale of any security.

[3] The district court for the Eastern District of Pennsylvania first implied a private right of action under § 10(b) of the '34 Act in 1946. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946). Although a majority of courts soon recognized the private right of action under § 10(b), *e.g.*, Fratt v. Robinson, 203 F.2d 627, 632 (9th Cir. 1953); Osborne v. Mallory, 86 F. Supp. 869, 879 (S.D.N.Y. 1949), the Supreme Court did not affirm the existence of such a right until 1971. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971).

[4] *See generally* 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD §§ 2.4(2)-.5 (1976) [hereinafter cited as BROMBERG & LOWENFELS].

have been actionable under an express liability provision.[5] Recently, however, several lower federal courts have dealt with the question of whether an implied right of action exists under section 10(b) when an express remedy prescribes the defendant's conduct.[6]

Congress provided several express remedies in both the '33 Act and the '34 Act. Congress enacted the '33 Act to regulate the sale of newly issued securities.[7] The Act was specifically designed to provide full and fair disclosure of the character of the securities sold and to prevent fraud in the sale of the securities.[8] Although Congress provided primarily for government enforcement in the '33 Act, Congress also supplied three express private remedies to investors.[9] The restrictive nature of the express liability provisions reflects a congressional concern that the remedies not upset the new issues market.[10] The philosophy of Congress in enacting the express remedies was deterrence rather than compensation.[11]

To further the requirement of accurate disclosure,[12] Congress provided for an express private remedy in section 11 of the '33 Act.[13] Section 11 subjects issuers of registered securities and other persons[14] to civil liability for false statements or omissions of material facts in a

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[5] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211 n.31 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752 n.15 (1975).

[6] *E.g.*, Wachovia Bank & Trust Co. v. National Student Marketing Corp., [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712 (D.C. Cir. 1980); Ross v. A.H. Robins Co., 607 F.2d 545 (2d Cir. 1979); McFarland v. Memorex Corp., 493 F. Supp. 631 (N.D. Cal. 1980).

[7] *See* Ch. 38, 48 Stat. 74 (1933) (current version at 15 U.S.C. §§ 77a-77bbbb (1976)).

[8] *See id.* The goal of the '33 Act was investor protection. Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 564 (E.D.N.Y. 1971). Congress sought to protect investors through a general antifraud provision and a registration provision. *See* L. LOSS, SECURITIES REGULATION 179-80 (1961) [hereinafter cited as LOSS]. The disclosure provisions of the Securities Act of 1933 ('33 Act) require not only accuracy but also the disclosure of significant matters which rarely had been disclosed previously. *See* Shulman, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 227 (1933) [hereinafter cited as Shulman].

[9] 15 U.S.C. §§ 77k, 77l, 77o (1976); *see* H.R. REP. No. 85, 73d Cong., 1st Sess. 9-10 (1933).

[10] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752-53 (1975). In the 1934 amendments, Congress further restricted the already-limited remedies of the '33 Act. *Id.; see* 78 CONG. REC. 8668-69 (1934); notes 17, 24 and 26 *infra*. The 1934 amendments were a response to pressure from the securities industry. *See* James, *Amendments to the Securities Act of 1933*, 32 MICH. L. REV. 1130, 1130 (1934). *See generally* M. PARRISH, SECURITIES REGULATION AND THE NEW DEAL (1970).

[11] Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970); Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 567 (E.D.N.Y. 1971); *see* Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172-73 (1933) (penalty must be severe to make truth-telling requirement effective); Shulman, *supra* note 8, at 227, 253 (adequate deterrence eliminates need for compensation).

[12] *See* H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933); note 8 *supra*.

[13] 15 U.S.C. § 77k (1976).

[14] Potential § 11 defendants include persons signing the registration statement, persons preparing or certifying the registration statement or a connected document, and the underwriter. *Id. See generally* Fiflis, *Liability for Misleading Statements under Section 11*, 21 PRAC. LAW. 35, 38-40 (1975).

registration statement.[15] Recognizing that facts relating to misstatements and omissions are peculiarly within the knowledge of the defendant, Congress placed the burden on the defendant to prove that he did not make false statements or fail to include material facts.[16] Except for a narrow exception, section 11 does not compel the purchaser to prove that he relied on the registration statement.[17] Further, section 11 does not require proof of scienter since liability depends on the existence of the statement or omission, rather than the intentions or good faith of the defendants.[18]

Congress was careful to limit the scope of section 11 liability. Only a defrauded purchaser of newly registered securities may sue under section 11.[19] The plaintiff is limited to recovery within a detailed measure-of-damages formula.[20] In addition, the defendant has several affirmative defenses. The defendant will be absolved of liability if he exercised due diligence[21] or if the plaintiff knew of the untruth or omission.[22] The causa-

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[15] 15 U.S.C. § 77k (1976).

[16] *See id* § 77(b); H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933).

[17] 15 U.S.C. § 77k (1976). In the 1934 amendments to the '33 Act, Congress stipulated that the plaintiff must prove reliance if he acquired the security after the issuer had submitted an earnings statement covering a period of at least 12 months after the effective date of the registration statement. Title II of the Securities Exchange Act of 1934, ch. 404, § 206, 48 Stat. 907; *see* H.R. REP. No. 1038, 73d Cong., 2d Sess. 41 (1934) (amendment based on likelihood that purchase of securities after publication of statement will be based on statement).

[18] Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 786-87 (2d Cir. 1951); Simpson, *Investors' Civil Remedies Under the Federal Securities Laws*, 12 DEPAUL L. REV. 71, 72-73 (1963) [hereinafter cited as Simpson].

[19] Barnes v. Osofsky, 373 F.2d 269, 273 (2d Cir. 1967); Abrams v. Johns-Manville Corp., [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,305, at 97,089-90 (S.D.N.Y. 1980); *see* 3 LOSS, *supra* note 8, at 1731 n.160.

[20] 15 U.S.C. § 77k(e) (1976). The purchaser may recover for damages suffered as a result of a decline in the security's value, in an amount not exceeding the price at which the security was offered to the public. *Id.; see* H.R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933) (greater allowance for damages would unnecessarily restrain conscientious business administration).

[21] 15 U.S.C. § 77k(b)(3)(A) (1976). The "due diligence" defense is not available to the issuer. *Id.* § 77k(b). The defense imposes a stringent standard of care on a defendant regarding the portions of a registration statement which were not made on the authority of an expert. *Id.* The § 11 defendant must establish that he conducted a reasonable investigation and therefore had reasonable grounds to believe, and did believe, the accuracy of the non-expertised portions of the registration statement. *Id.* § 77k(b)(3)(A); *see id.* § 77k(c) (reasonableness standard that of prudent man managing own property). The district court in Escott v. Barchris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968), indicated that "reasonable investigation" requires that the defendant independently verify the registration statement by referring to original written records. *Id.* at 690; *accord*, Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 576-77 (E.D.N.Y. 1971). The "reasonable investigation" requirement varies according to the defendant's status, with inside directors and underwriters subject to particularly stringent investigation requirements. 332 F. Supp. at 577-78. *See generally* Folk, *Civil Liabilities Under the Federal Securities Acts—The* Barchris *Case* (pt. 1), 55 VA. L. REV. 1 (1969); Comment, Barchris: *Due Diligence Refined*, 68 COLUM. L. REV. 1411 (1968).

[22] 15 U.S.C. § 77k(b)(3)(A) (1976).

tion provision of section 11 permits the defendant to prove that outside factors, rather than his misstatement or omission, accounted for some or all of the security's price decline.[23] Section 11 also has restrictive procedural requirements, including a short statute of limitations,[24] limited venue,[25] and the grant of judicial discretion to require plaintiffs to post a security bond for costs.[26]

In addition to insuring the accuracy of the registration statement's contents, Congress provided express remedies to insure that companies register their stock issues and that the representations accompanying the registration statement are accurate. Section 12(1) of the '33 Act imposes liability on an issuer, underwriter, or dealer who fails to register a security when registration is required under the '33 Act.[27] Since the plaintiff does not have to prove scienter or defend against allegations regarding his own knowledge, failure to register a security when so required results in absolute liability under section 12(1).[28] Under section 12(2) of the '33 Act, any person who sells securities by means containing material misstatements or omissions may be liable.[29] Unlike section 11, section 12(2) covers transactions in outstanding securities as well as

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[23] *Id.* § 77k(e). Commentators originally believed that § 11's causation provision offered little opportunity for reducing damages because of the difficulty of proving what caused a security to decline in value in the open market. *E.g.*, R. JENNINGS & H. MARSH, SECURITIES REGULATIONS: CASES AND MATERIALS 1027 (3d ed. 1972). Recent courts, however, have recognized that the provision may reduce defendants' damages occurring during periods of general market decline. *E.g.*, Beecher v. Able, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,016, at 97,559-60 (S.DN.Y. 1975); Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 586-87 (E.D.N.Y. 1971). *See generally* Note, *Causation of Damages Under Section 11 of the Securities Act of 1933*, 51 N.Y.U. L. REV. 217 (1976).

[24] 15 U.S.C. § 77m (1976). Section 13 of the '33 Act specifies the statute of limitations for §§ 11, 12 and 15. *Id.* Congress amended § 13 in 1934, reducing the period of limitations from two years to one year after discovery and from ten years to three years within the time of offer or sale of the security. *Compare* Title II of the Securities Exchange Act of 1934, ch. 404, § 207, 48 Stat. 908 (codified at 15 U.S.C. § 77m (1976)) *with* Securities Acts of 1933, ch. 38, § 13, 48 Stat. 84. The plaintiff must bring a § 11 action within one year after discovery of the violation and within three years after the issuer first offered the security to the public. 15 U.S.C. § 77m (1976).

[25] 15 U.S.C. § 77v(a) (1976). Venue lies where the defendant is found, resides, or transacts business, or where the offer or sale took place. *Id.*

[26] *Id.* § 77k(e). Section 11(e) authorizes a court to require a plaintiff bringing a suit under §§ 11, 12 or 15 to post a bond for costs, including attorneys' fees, and in specified circumstances to assess costs at the conclusion of the litigation. *Id.* Until Congress amended § 11(e) in the '34 amendments to the '33 Act, § 11(e) contained no provision for payment of costs. *Compare* Title II of the Securities Exchange Act of 1934, ch. 404, § 206(e), 48 Stat. 907 *with* Securities Act of 1933, ch. 38, § 11(e), 48 Stat. 83. Congress amended § 11(e) to deter plaintiffs from bringing actions solely for their potential settlement value. *See* H.R. REP. No. 1838, 73d Cong., 2d Sess. 42 (1934); 78 CONG. REC. 8669 (1934).

[27] 15 U.S.C. § 77l(1) (1976).

[28] *See* 3A H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 8.04 (1980); R. JENNINGS & H. MARSH, SECURITIES REGULATION: CASES AND MATERIALS 839 (4th ed. 1977).

[29] 15 U.S.C. § 77l(2) (1976).

distribution.[30] Congress placed the burden on the defendant to prove that he did not make the false statements or fail to disclose material facts.[31]

Congress carefully limited the scope of section 12 liability. A purchaser may sue only his immediate seller for violations of section 12.[32] Because of this "strict privity" requirement, the purchaser may sue the issuer of a security under section 12(2) only if he purchased from an agent or "control person" of the issuer.[33] The potential availability of several defenses further limits section 12(2). The defendant will not be liable if the plaintiff fails to prove his own lack of knowledge of the misstatement or omission.[34] In addition, the section 12(2) defendant may absolve himself from liability if he proves that he did not know about the misstatements or omissions, and could not have learned the truth by the exercise of reasonable care.[35] Congress imposed restrictive provisions on section 12 concerning its statute of limitations,[36] venue,[37] and security bond requirements.[38] If a plaintiff can satisfy the restrictive elements of a section 12(2) action, his damages are limited to recission and recovery of the consideration paid for the security with interest, or recovery of damages if he no longer owns the security.[39]

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[30] 5 A. JACOBS, THE IMPACT OF RULE 10b-5, § 3.01[c], at 1-43 (rev. ed. 1980) [hereinafter cited as JACOBS].

[31] 15 U.S.C. § 77l(2) (1976).

[32] *Id.* § 77l; Demarco v. Edens, 390 F.2d 836, 841 n.3 (2d Cir. 1968); 3 LOSS, *supra* note 8, at 1719. Only immediate sellers are liable under § 12, since Congress provided a specific remedy against an issuer under § 11. Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979). Several courts have recognized, however, that the term "seller" under § 12 may include more than just the person who passes title. *See, e.g.*, Lennerth v. Mendenhall, 234 F. Supp. 59, 65 (N.D. Ohio 1964) (defendant liable if conduct directly and proximately caused plaintiff's injury); *accord*, Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 692-93 (5th Cir. 1971) (promoters of nationwide franchise operation liable under § 12(1)); *In re* Caesars Palace Secs. Litigation, 360 F. Supp. 366, 378-83 (S.D.N.Y. 1973) (aider and abettor liable under § 12(2)). *See generally* Rapp, *Expanded Liability Under Section 12 of the Securities Act: When is a Seller Not a Seller?*, 27 CASE W. RES. L. REV. 445 (1977).

[33] 15 U.S.C. § 77l(2) (1976); *see* note 39 *infra* (definition of "control person").

[34] 15 U.S.C. § 77l(2) (1976).

[35] *Id.* One commentator has suggested that the "reasonable care" defense under § 12(2) involves the same requirements as the "due diligence" defense under § 11. Folk, *Civil Liabilities Under the Federal Securities Acts: The* Barchris *Case* (pt. 2), 55 VA. L. REV. 199, 207-16 (1969); *see* note 21 *supra*.

[36] 15 U.S.C. § 77m (1976); *see* note 24 *supra*. A plaintiff must bring a § 12(1) action within one year after the violation and within three years after the seller first offered the security to the public. 15 U.S.C. § 77m (1976); *see* Russell v. Travel Concepts Corp., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,230, at 98,217 (M.D. Tenn. 1975) (rejecting argument that statute begins to run with plaintiff's discovery of alleged violation). A plaintiff must bring a § 12(2) action within one year after discovery of the misrepresentation and within three years of the sale. 15 U.S.C. § 77m (1976); *see* Gould v. Tricon, Inc., 272 F. Supp. 385, 391 (S.D.N.Y. 1967) (action must be brought within one year after reasonably diligent plaintiff could have discovered misrepresention).

[37] 15 U.S.C. § 77v(a) (1976); *see* note 25 *supra*.

[38] 15 U.S.C. § 77k(e) (1976); *see* note 26 *supra*.

[39] 15 U.S.C. § 77l (1976). A § 12 plaintiff may recover only recissionary damages, unless

In the '34 Act, Congress established a complementary scheme to the '33 Act by regulating post-distribution trading on stock exchanges and securities trading markets.[40] The '34 Act was designed to protect public investors by requiring that issuers continually disclose detailed information about their securities and by regulating the open market trading of those securities.[41] Congress again gave primary enforcement responsibilities to the government, but provided three express civil remedies in sections 9(e), 16(b), and 18.[42] In response to pressure from the corporate sector, Congress limited severely the scope of these express liability provisions.[43] Congress intended the remedies to deter illicit practices, rather than to compensate injured parties.[44]

Section 9(e) of the '34 Act imposes liability on any person who willfully engages in manipulative activities in connection with securities registered on exchanges.[45] In addition to willfulness,[46] a plaintiff must show that the manipulation actually affected the price at which he bought or sold the security.[47] If he satisfies these elements, the plaintiff

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he already has disposed of the stock. Pfeffer v. Cressaty, 223 F. Supp. 756, 757 (S.D.N.Y. 1963). Congress imposed a recissionary damage remedy on § 12 because of the section's strict privity requirement. *See* Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir. 1971), *cert. denied*, 404 U.S. 1064 (1972).

In addition to the express remedies of §§ 11 and 12, Congress imposed civil liability on "control persons" under § 15 of the '33 Act. 15 U.S.C. § 77o (1976); *see* Note, *Vicarious Liability of Controlling Persons Under the Securities Acts*, 11 LOY. L.A. L. REV. 151, 155-57 (1977) (courts define "control persons" on basis of status or control over transaction or institution through which perpetrator acted). Section 15 provides for secondary liability on the part of control persons for violations of §§ 11 and 12, rather than creating a direct cause of action against control persons. 15 U.S.C. §§ 77o (1976); Turner v. First Wis. Mortgage Trust, 454 F. Supp. 899, 913 (E.D. Wis. 1978). Congress provided an affirmative defense under § 15 based on the defendant's lack of knowledge of the misstatement or omission. 15 U.S.C. § 77o (1976); *see* Demarco v. Edens, 390 F.2d 836, 842-43 (2d Cir. 1968) (control person satisfies defense if he exercises reasonable care of prudent person).

[40] *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752 (1974); 1 LOSS, *supra* note 8, at 130-31.

[41] *See* S. REP. No. 792, 73d Cong., 2d Sess. 3-5 (1934); H.R. REP. No. 1383, 73d Cong., 2d Sess. 10 (1934).

[42] 15 U.S.C. §§ 78i(e), 78p(b), 78r (1976); *see* S. REP. No. 792, 73d Cong., 2d Sess. 5 (1934).

[43] 3 LOSS, *supra* note 8, at 1746-47; Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340, 1369 (1966) [hereinafter cited as Cohen]. Professor Loss has stated that Congress "watered down" the strength of the express remedies in the '34 Act to avoid the possibility that corporations would strike against listing their securities on stock exchanges. 3 LOSS, *supra* note 8, at 1746-47. Due to their watered-down nature, the express remedies of the '34 Act have been "somewhat ineffective" in deterring fraudulent and deceptive conduct. *Id.*; *see* Note, *The Exclusivity of the Express Remedy Under Section 18(a) of the Securities Exchange Act of 1934*, 46 GEO. WASH. L. REV. 845, 847 (1978) [hereinafter cited as *Express Remedy*].

[44] *See* S. REP. No. 792, 73d Cong., 2d Sess. 12-13 (1934).

[45] 15 U.S.C. § 78i(e) (1976).

[46] Section 9(e) is the only civil liability provision in the securities acts that contains the requirement of willfulness. *See* 3 LOSS, *supra* note 8, at 1749.

[47] 15 U.S.C. § 78i(e) (1976).

may recover damages. Section 9(e) limits damages, however, to losses resulting directly from the unlawful price manipulation.[48] Finally, the plaintiff must satisfy the section's statute of limitations provision[49] and any court-imposed security bond for costs.[50]

Section 16(b) of the '34 Act allows the issuer of a security to recover all short-swing profits from insiders.[51] Congress designed section 16(b) to prevent the unfair use of information which an insider may have obtained through his relationship with the issuer.[52] The remedy is relatively free of the restrictive provisions characteristic of other express remedies under the securities acts. Liability is automatic upon plaintiff's proof that the insider profited on a purchase and sale, or sale and purchase, of his corporation's securities within a six month period.[53] A security holder suing on behalf of the issuer under section 16(b) may collect attorneys' fees,[54] and is not required to post security for costs.[55] A section 16(b) plaintiff must, however, bring the action within two years after the date the insider realized the profit.[56]

Section 18 of the '34 Act provides a right of action against persons who have made misstatements or omissions[57] in any application, report, or document filed with the SEC pursuant to the '34 Act or SEC Rules.[58]

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[48] *Id.* Section 9(e) also provides that persons liable shall have a right of contribution from any person who, if joined in the original suit, would have been liable to make the same payment. *Id.*

[49] *Id.* A plaintiff must bring a § 9(e) action within one year after discovery of the facts constituting the violation and within three years after the actual manipulation. *Id.*

[50] *Id.*; *see* S. REP. No. 792, 73d Cong., 2d Sess. 18 (1934) (defendant must show that action was brought in bad faith before court should impose costs on plaintiff).

[51] 15 U.S.C. § 78p(b) (1976). Section 16(b) authorizes a private remedy by which the issuer may recover any profit gained by the insider through a short swing transaction. *Id.* The section does not, however, make the insider's transaction unlawful. *See* Bloomenthal, *Market-Makers, Manipulators and Shell Games*, 45 ST. JOHN'S L. REV. 597, 631 n.132 (1971).

[52] *See* 15 U.S.C. § 78p(b) (1976); S. REP. No. 792, 73d Cong., 2d Sess. 20-21 (1934).

[53] 15 U.S.C. § 78p(b) (1976). An insider's transaction may violate § 16(b) even though the insider did not use inside information and acted in good faith. JACOBS, *supra* note 30, § 3.02[g], at 1-100; *see Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 6557 (1934) (remarks of T. Corcoran) (§ 16(b) is "crude rule of thumb" because of difficulty of proving insider's intent).

[54] JACOBS, *supra* note 30, § 3.02[g], at 1-100; *see* Smolowe v. Delendo Corp., 136 F.2d 231, 241 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) (potential recovery of attorneys' fees may provide sole stimulus for § 16(b)'s enforcement).

[55] JACOBS, *supra* note 30, § 3.02[g], at 1-100.

[56] 15 U.S.C. § 78p(b) (1976).

[57] Congress intended that the language of § 18 encompass omissions as well as misrepresentations. *In re* Pennsylvania Cent. Secs. Litigation, 357 F. Supp. 869, 876-77 (E.D. Pa. 1973), *aff'd*, 494 F.2d 528 (3d Cir. 1974); H.R. REP. No. 1838, 73d Cong., 2d Sess. 36 (1934).

[58] 15 U.S.C. § 78r(a) (1976). The '34 Act requires the filing of a wide variety of documents with the SEC. Section 13(a) contains the most important reporting requirement. Under § 13(a), most publicly held companies must submit an annual report on Form 10-K and provide other financial and nonfinancial information about their operations during the course of a year. *See id.* § 78m. *See generally* 5 JACOBS, *supra* note 30, § 3.02[h] (discussion of all filing requirements under '34 Act).

A majority of courts have held that § 18 is the "catch-all" civil liability provision for

Congress carefully and narrowly drafted the language of section 18.[59] Section 18 liability does not extend to misleading documents filed with any agency other than the SEC.[60] The section places upon the plaintiff a difficult burden of proof. First, the plaintiff must prove that he saw and relied on the misstatement in the report filed with the SEC.[61] The plaintiff next must prove that the defendant's misrepresentation affected the price of the security.[62] In addition, the defendant may escape liability by

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violations of the reporting requirements of the '34 Act and thus have refused to imply private rights of action under the individual reporting requirements. *See, e.g.*, DeWitt v. American Stock Transfer Co., 433 F. Supp. 994, 1005 (S.D.N.Y. 1977) (§§ 13(a) & 15(d)); Myers v. American Leisure Time Enter., Inc., 402 F. Supp. 213, 214-15 (S.D.N.Y. 1975), *aff'd mem.*, 538 F.2d 312 (2d Cir. 1976) (§ 13 (d)); *In re* Pennsylvania Cent. Secs. Litigation, 347 F. Supp. 1327, 1340 (E.D. Pa. 1972), *aff'd*, 494 F.2d 528 (3d Cir. 1974) (§ 13(a)).

[59] Higgins, *Section 18 of the Exchange Act: A New Defense Weapon in Securities Litigation*, 1980 DET. COLL. OF L. REV. 761, 763-64 [hereinafter cited as Higgins]. The careful drafting of § 18 reflects Congress' concern with establishing a balance between affording an adequate remedy to injured persons and, on the other hand, exposing corporations, directors and auditors to staggering liability because of their duty to file reports with the SEC. *Id.*

[60] *See* Dorfman v. First Boston Corp., 336 F. Supp. 1089, 1097-98 (E.D. Pa. 1972) (documents filed with Interstate Commerce Commission not actionable under § 18); Gann v. Bernzomatic Corp., 262 F. Supp. 301, 304 (S.D.N.Y. 1966) (misrepresentations in non-filed documents not actionable under § 18). *But cf.* Fischmann v. Raytheon Mfg. Co., 188 F.2d 783, 788 (2d Cir. 1951) (imposing § 18 liability even though document filed only with stock exchange).

Section 18 liability also is limited within the class of documents which a company must file with the SEC. *See* Note, *Section 18 of the Securities Exchange Act of 1934: Putting the Bite Back into the Toothless Tiger*, 47 FORDHAM L. REV. 115, 128-31 (1978) [hereinafter cited as *Toothless Tiger*]. The SEC expressly has exempted Form 10-Q quarterly reports from liability under § 18. 17 C.F.R. § 240.15d-13(d) (1980). Annual reports are not "filed" for purposes of liability under § 18(a). *Id.* § 240.149-3(c).

[61] 15 U.S.C. § 78r(a) (1976). The § 18 plaintiff must establish "eye-ball" reliance on the report which contains the misstatement or omission. Heit v. Weitzen, 402 F.2d 909, 916 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969); Barotz v. Monarch Gen., Inc., [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,933, at 97,237 (S.D.N.Y. 1975). Since § 11 contains a provision enabling the plaintiff to establish reliance "without proof of the reading" of the particular document, courts have reasoned that the absence of such a provision in § 18 requires reliance on the actual document. 402 F.2d at 916 & n.6; *see* 3 LOSS, *supra* note 8, at 1752. Several commentators believe, however, that the § 18 plaintiff should not be required to establish "eye-ball" reliance. *See, e.g.*, 5 JACOBS, *supra* note 30, § 3.02[h], at 1-110 n.22 (1980) (sufficient if plaintiff read abstract of report or relied on security's market price); 2A BROMBERG, SECURITIES LAW § 8.4(469) (1975) (sufficient if plaintiff saw relevant parts of report in some other source); *accord*, Jacobson v. Peat, Marwick, Mitchell & Co., 445 F. Supp. 518, 525 (S.D.N.Y. 1977); 3 LOSS, *supra* note 8, at 1753 n.227 (may be sufficient if investor relies on information found through statistical services and otherwise). *See generally* Higgins, *supra* note 59, at 774-81.

[62] 15 U.S.C. § 78r(a) (1976); *see* Rich v. Touche Ross & Co., 415 F. Supp. 95, 103 (S.D.N.Y. 1976). The SEC considers the § 18(a) requirement that plaintiffs prove that the defendant's misrepresentation affected the price of the security a major disincentive to the use of § 18(a). *See* LOSS, *supra* note 8, at 1753-54. In the 1941 amendments to the '34 Act, the Commission unsuccessfully sought to strike the requirement. *See* SEC REPORT ON PROPOSALS FOR AMENDMENTS TO THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, H.R. COMM. PRINT, COMM. ON INT. & FR. COMMERCE, 77th Cong., 1st Sess. 38 (1941).

showing that he acted in good faith and without knowledge that the statement was false or misleading.[63] Damages recoverable under section 18 do not include losses attributable to a general market decline.[64] A section 18 action is further subject to restrictive procedural requirements, including a short statute of limitations[65] and the potential imposition of security for costs and assessment of attorneys' fees.[66]

In addition to express remedies in the '33 and '34 Acts prohibiting fraud, Congress enacted section 10(b) as part of the '34 Act.[67] Congress intended section 10(b) to grant the SEC[68] the authority to enjoin manipulative and deceptive conduct not otherwise prohibited by the '33 and '34 Acts.[69] Congress designed section 10(b) to permit the SEC to regulate instances of fraud that were neither prevalent nor envisioned by Congress in 1934.[70] Because a civil remedy under section 10(b) is a

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[63] 15 U.S.C. § 78r(a) (1976). The legislative history of the § 18 "good faith" defense indicates that the defendant's actions must be "something more than negligence" for the plaintiff to recover. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211-12 n.31 (1976).

[64] 15 U.S.C. § 78r(a) (1976).

[65] *Id.* § 78r(c). A plaintiff must bring a § 18 action within one year of discovering the facts constituting the cause of action and within three years after the cause of action accrues. *Id.*; *see* Jacobson v. Peat, Marwick, Mitchell & Co., 445 F. Supp. 518, 527 (S.D.N.Y. 1977) (cause of action "accrues" when transaction for which plaintiff seeks damages takes place).

[66] 15 U.S.C. § 78r(a) (1976). Congress provided for the discretionary assessment of costs and attorneys' fees under § 18 in order to protect against strike suits. *See* S. REP. No. 792, 73d Cong., 2d Sess. 21 (1934). The defendant must show that the action was brought in bad faith or is without merit before a court will impose costs on the plaintiff. Rhoadside v. Kenmore, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,958, at 97,290 (S.D.N.Y. 1975).

In addition to the express remedies provided in §§ 9(e), 16(b), and 18 of the '34 Act, § 20(a) provides for the secondary liability of "control persons" for violations of the express remedies. 15 U.S.C. § 78t(a) (1976). *See generally* Note, *The Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934*, 48 N.Y.U. L. REV. 1019 (1973). A defendant is not liable under § 20(a) if he acted in good faith and did not induce directly or indirectly the act constituting the violation. 15 U.S.C. § 78t(a) (1976); *see* Lorenz v. Watson, 258 F. Supp. 724, 732-33 (E.D. Pa. 1966) (control person satisfies § 20(a) good faith defense by proving that he took some precautionary measures to prevent plaintiff's harm).

[67] 15 U.S.C. § 78j(b) (1976); *see* note 1 *supra*.

[68] Section 10(b) only provides expressly for SEC enforcement. *See* 15 U.S.C. § 78j(b) (1976); S. REP. No. 792, 73d Cong., 2d Sess. 18 (1934). The legislative history of § 10(b) does not indicate that Congress considered the problem of private suits under the section at the time of its enactment. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729-30 (1975); *see* S. REP. No. 792, 73d Cong., 2d Sess. 5-6 (1934); Note, *Implied Liability Under the Securities Exchange Act*, 61 HARV. L. REV. 858, 860-61 (1948). Similarly, there is no indication that the SEC considered the question of private civil remedies in adopting rule 10b-5. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. at 729-30; *see Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).

[69] 2 LOSS, *supra* note 8, at 3528 (Supp. 1969); *see* JACOBS, *supra* note 30, § 3 (Congress recognized need for remedy in areas not expressly covered by '33 or '34 Act).

[70] *See Hearings on Stock Exchange Regulation Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 21 (remarks of J. Landis) (§ 10(b) gives SEC

creature of judicial implication, courts have been responsible for defining the elements of a section 10(b) action.[71] In establishing a claim under section 10(b), a plaintiff must show that the defendant misstated or omitted a material fact that injured the plaintiff in connection with the plaintiff's purchase or sale of a security.[72] The plaintiff has the burden of proving scienter.[73] Although reliance is a required element in a section 10(b) action,[74] courts presume reliance once a plaintiff establishes materiality[75] or proves that the material misrepresentations affected the open market price of the stock.[76] Courts use the out-of-pocket rule, which looks to the

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general power to prescribe regulation of any other manipulative devices); *id.* at 115 (remarks of T. Corcoran) (§ 10(b) is catch-all provision to enable SEC to deal with new manipulative devices). *See generally* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U. L. REV. 627, 657-59 (1963) [hereinafter cited as Ruder].

[71] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 748-49 (1975).

[72] 15 U.S.C. § 78j(b) (1976); *see* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474 n.14 (1977) (material misstatement or omission required); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730-31 (1975) (plaintiff must be purchaser or seller of securities).

[73] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-214 (1976). A § 10(b) defendant acts with scienter when he engages in "knowing or intentional" misconduct. *Id.* at 197. Most courts and commentators consider reckless behavior sufficient to meet the scienter requirement. *E.g.*, Rolf v. Blythe, Eastman Dillon & Co., 570 F.2d 38, 44-47 (2d Cir. 1978); Sunstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977); JACOBS, *supra* note 30, § 63, at 3-199 to -200; Steinberg & Gruenbaum, *Variations of "Recklessness" After* Hochfelder *and* Aaron, 8 SECS. REG. L. J. 179, 181-82 (1980); Note, *Recklessness Under Section 10(b): Weathering the* Hochfelder *Storm*, 8 RUT.-CAM. L. J. 325, 343-44 (1977).

Prior to the Supreme Court's imposition of the scienter requirement in *Hochfelder*, courts imposed a "due care" requirement on § 10(b) plaintiffs. *See* Note, *Abrogation of Plaintiff's Due Care Requirement in Private Actions Under Rule 10b-5*, 28 CASE W. RES. L. REV. 399, 414 (1978). Under this requirement, a plaintiff would be denied recovery when both parties acted negligently and the plaintiff failed to conduct an investigation which would have revealed the defendant's misrepresentation. *See id.* After *Hochfelder*, however, most courts have not required § 10(b) plaintiffs to establish "due care," since courts can no longer impose liability on defendants for mere negligence. *See id.*; Note, *Due Care: Still a Limitation on 10b-5 Recovery?*, 61 MARQ. L. REV. 122, 139 (1977).

[74] Titan Group, Inc. v. Faggen, 513 F.2d 234, 239 (2d Cir.), *cert. denied*, 423 U.S. 840 (1975); List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 381 U.S. 908 (1965).

[75] Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972). *See generally* Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 HARV. L. REV. 584 (1975) [hereinafter cited as *Reliance Requirement*]. Most courts presume reliance only when the defendant's fraudulent conduct involves material omissions rather than misrepresentations. *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 240 (2d Cir. 1974); Rochez Bros., Inc. v. Rhoades, 491 F.2d 402, 409-10 (3d Cir. 1974), *cert. denied*, 425 U.S. 993 (1976). *But see* note 76 *infra*. An omission is "material" if a reasonable investor might have considered the omission important in making his investment decision. Affiliated Ute Citizens v. United States, 406 U.S. at 153-54. If the omission is material, the defendant may rebut the presumption of reliance by showing that the plaintiff would not have acted differently even if the plaintiff had known the undisclosed material facts. Rifkin v. Crow, 574 F.2d 256, 262 (5th Cir. 1978).

[76] The Ninth and Second Circuits presume reliance in cases in which the deception has inflated the price of securities traded in the open market. Blackie v. Barrack, 524 F.2d 891, 906-07 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); Schlich v. Penn-Dixie Cement Corp.,

value received at the time of purchase, to determine damages under section 10(b).[77] The plaintiff in a section 10(b) action is entitled to a long statute of limitations[78] and a broad venue option,[79] and need not post security for costs.[80]

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507 F.2d 374, 381 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975). *See generally Reliance Requirement, supra* note 75, at 592-96; Note, *Proof of Reliance is Unnecessary in Open Market Transactions Under 10b-5*, 29 VAND. L. REV. 287 (1976). An individual reliance requirement in cases involving fraud on the market would impose an unreasonable evidentiary burden on a § 10(b) plaintiff. Blackie v. Barrack, 524 F.2d at 906.

[77] Beecher v. Able, 435 F. Supp. 397, 412 (S.D.N.Y. 1977). *See generally* Jacobs, *The Measure of Damages in Rule 10b-5 Cases*, 65 GEO. L. J. 1093 (1977) [hereinafter cited as *Measure of Damages*]. Under § 10(b), a defrauded buyer may recover the fair value of the consideration he paid for the security minus the actual value of the security, as measured at the time of the transaction. Levine v. Seilon, Inc., 439 F.2d 328, 334 (2d Cir. 1971). When the out-of-pocket rule fails to compensate the defrauded buyer for injuries which extend beyond the initial bargain, however, a court may apply a recissionary damage remedy. *See* Garnatz v. Stifel, Nicolaus & Co., 559 F.2d 1357, 1360-61 (8th Cir. 1977) (plaintiff recovered decline in bonds' value until actual or constructive notice of fraud). *But see* Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 49 n.22 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978) (defendants not liable for general market decline). Under the out-of-pocket rule, a defrauded seller may recover the fair value of the stock he sold minus the purchase price received, as measured at the time of the transaction. Levine v. Seilon, Inc., 439 F.2d 328, 334 (2d Cir. 1971). Recissionary damages may be available. Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972). *See generally* Note, *Rule 10b-5 Damages: The Runaway Development of a Common Law Remedy*, 28 U. FLA. L. REV. 76 (1975).

[78] Section 10(b) does not contain an express statute of limitations. *See* 15 U.S.C. § 78j(b) (1976). Consequently, federal courts apply the limitations period available under the law of the forum state. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 n.29 (1976). Courts differ as to whether to apply the limitations period in the state blue sky law or the state statute of limitations for common-law fraud. Block & Barton, *Statute of Limitations in Private Actions Under Section 10(b) — A Proposal for Achieving Uniformity*, 7 SECS. REG. L. J. 374, 375 (1980); *see, e.g.*, Roberts v. Magnetic Metals Co., 611 F.2d 450, 452 (3d Cir. 1979) (applied six year limitations period of New Jersey's common law fraud remedy); Ohio v. Peterson, Lowry, Rall, Barber & Ross, 472 F. Supp. 402, 406 (D. Colo. 1979) (applied three year limitations period of Colorado's blue sky statute). Courts frequently choose the longer statute of limitations in order to maximize the investor protection function of the securities laws. Note, *Securities Actions: Equitable Defenses and the Good Faith Defense for "Controlling Persons,"* 44 FORDHAM L. REV. 1173, 1192 (1976). Courts may extend the limitations period indefinitely by use of the federal tolling doctrine. Under this doctrine, the limitations period does not begin to run until the plaintiff knew or should have known of the fraud or at least of facts sufficient to put him on notice that he has been victimized. *See* Arneil v. Ramsey, 550 F.2d 774, 780-81 (2d Cir. 1977) (§ 10(b) statute of limitations does not begin to run until plaintiffs should have discovered general fraudulent scheme); Hupp v. Gray, 500 F.2d 993, 996 (7th Cir. 1974) (investor using due diligence in attempting to discover fraudulent scheme may invoke federal tolling doctrine in § 10(b) suits).

[79] *See* 15 U.S.C. § 78aa (1976). Section 27 of the '34 Act, which applies to § 10(b), is similar to the venue provisions for §§ 11 and 12(2) of the '33 Act in permitting venue wherever the defendant is located, resides, or transacts business, or where the offer or sale took place. *Id.; see* note 25 *supra*. In addition, § 27 allows venue in any district where an act or transaction constituting a violation occurred. 15 U.S.C. § 78aa (1976).

[80] Courts may not require a § 10(b) plaintiff to post security for costs and expenses. McClure v. Borne Chem. Co., 292 F.2d 824, 830 (3d Cir.), *cert. denied*, 368 U.S. 939 (1961); Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 788-89 (2d Cir. 1951). In addition, a district

Because of the restrictions in the express remedies of the '33 and '34 Acts, plaintiffs soon pressed courts to imply private rights of action under other sections of the securities acts for conduct that the express provisions proscribed.[81] Courts liberally construed these sections and the Supreme Court even urged the lower courts to imply private rights of action to further the remedial purposes of the securities acts.[82] During this period, plaintiffs particularly sought an implied remedy under section 10(b) of the '34 Act, because of the section's open-ended nature and ease of proof.[83] Courts freely granted an implied private right of action under section 10(b), reasoning that the express remedies and the section 10(b) implied remedy were cumulative.[84] The courts occasionally admitted that this construction indicated that Congress, in drafting the '34 Act, completely ignored or nullified the carefully drawn procedural restrictions of the '33 Act.[85] Nevertheless, the courts justified the implication of a private right of action under section 10(b) by noting that the implied remedy was consistent with the congressional policy of providing complete sanctions[86] and permitted the more recent '34 Act to govern in areas of overlap.[87]

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court may award attorneys' fees under § 10(b) only in rare instances. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210-11 n.30 (1975). Under the "American Rule," the prevailing party seldom can recover attorneys' fees in the absence of statutory authorization. Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 270-71 (1975); *see* F.D. Rich Co. v. United States *ex rel.* Industrial Lumber Co., 417 U.S. 116, 129-30 (1974) (may award attorneys' fees to prevailing party when opponent acted in bad faith).

[81] *See generally* JACOBS, *supra* note 30, § 3.

[82] J.I. Case Co. v. Borak, 377 U.S. 426, 433 (1964). In *Borak*, the Supreme Court implied a private right of action under § 14(a) of the '34 Act. *Id.* at 431-32. The court reasoned that the SEC alone could not fully enforce § 14(a), and held that the goals of the '34 Act required implication of a private remedy. *Id.* at 432-33. The *Borak* Court encouraged lower courts to imply private remedies under other sections of the securities laws. *Id.* at 433.

[83] Stewart v. Bennett, 359 F. Supp. 878, 881 (D. Mass. 1973).

[84] *E.g.*, Ellis v. Carter, 291 F.2d 270, 273-74 (9th Cir. 1961); Matheson v. Armbrust, 284 F.2d 670, 674-75 (9th Cir. 1960), *cert. denied*, 365 U.S. 870 (1961); Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 787 (2d Cir. 1951); Rosen v. Bergman, 40 F.R.D. 19, 21-22 (S.D.N.Y. 1966); Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946); *cf.*, Gilbert v. Nixon, 429 F.2d 348, 355 (10th Cir. 1970) (noting that buyer could have § 10(b) action, but adopting elements of § 12 when plaintiff sued under §§ 10(b) and 12). *But see* Rosenberg v. Globe Aircraft Corp., 80 F. Supp. 123, 124-25 (E.D. Pa. 1948) (§ 10(b) inapplicable when § 11 or § 12 action available); Montague v. Electronic Corp. of Am., 76 F. Supp. 933, 936 (S.D.N.Y. 1948) (§ 10(b) action inapplicable when § 11 or § 12 action available).

[85] *E.g.*, Ellis v. Carter, 291 F.2d 270, 273 (9th Cir. 1961); Orn v. Eastman Dillon, Union Secs. & Co., 364 F. Supp. 352, 354-55 (C.D. Cal. 1973).

[86] Ellis v. Carter, 291 F.2d 270, 273-74 (9th Cir. 1961). Courts imputed a broad congressional intent to § 10(b) on the basis of § 10(b)'s language and the remedial purposes of the securities act. *E.g.*, Schaefer v. First Nat'l Bank, 509 F.2d 1287, 1292-93 (7th Cir. 1975), *cert. denied*, 425 U.S. 943 (1976); Jordan Bldg. Corp. v. Doyle, O'Connor & Co., 401 F.2d 47, 51 (7th Cir. 1968).

[87] Ellis v. Carter, 291 F.2d 270, 274 (9th Cir. 1961). Courts characteristically asserted practical justifications for implication of a private right of action under § 10(b). *See id.*; Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 787 (2d Cir. 1951). The Ninth Circuit noted in

Recently, the Supreme Court's liberal attitude toward implication of private remedies has changed. The Court has abandoned its expansive remedial philosophy in favor of a strict analysis designed to ascertain whether Congress intended to create a private cause of action under the statute.[88]

An initial indication that the Court was adopting a more restrictive approach to implying a private right of action occurred in 1974. In *National Railroad Passenger Corp. v. National Association of Railroad Passengers (Amtrak)*,[89] the Court refused to imply a private right of action under section 307(a) of the Rail Passenger Service Act of 1970 because the section provided for a public action by the Attorney General.[90] The Court invoked the restrictive maxim of statutory construction, *expressio unius est exclusio alterius*, which holds that whenever Congress provides a specific remedy in one section of a statute, the omission of other remedies implies a legislative intent that the specified remedy be exclusive.[91] The Court stated that the *expressio* principle would yield only to clear evidence of contrary legislative intent.[92]

The Supreme Court continued the restriction of implied private

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Ellis that implication of a § 10(b) action would require no variances under the '34 Act between the buyer and the seller. 291 F.2d at 274. In *Fischman*, the Second Circuit stated that if § 11 were held to be an exclusive remedy, private plaintiffs could not proceed against "insiders" who induce investors to purchase common stock by placing fraudulent statements in documents filed with the SEC. 188 F.2d at 787. Other justifications for implication of a § 10(b) private remedy are less availing. *See, e.g.*, Seiden v. Nicholson, 69 F.R.D. 681, 684 (N.D. Ill. 1976) (implication of § 10(b) remedy because Congress would have stated so expressly if it had intended express remedies to be exclusive); Orn v. Eastman Dillon, Union Secs. & Co., 364 F. Supp. 352, 355 (C.D. Cal. 1973) (implication of § 10(b) remedy because § 28 of '34 Act provides that '34 Act remedies "shall be in addition to any and all other rights that may exist at law").

[88] *See, e.g.*, Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 15-17 (1979); Touche Ross & Co. v. Redington, 442 U.S. 560, 575-77 (1979); *see* text accompanying notes 124-30 *infra*.

[89] 414 U.S. 453 (1974).

[90] *Id.* at 458-59.

[91] *Id.* Literally, *expressio unius est exclusio alterius* means "the expression of one thing is the exclusion of another." BLACK'S LAW DICTIONARY 521 (5th ed. 1979); *see* Botany Worsted Mills v. United States, 278 U.S. 282, 288-89 (1929) ("when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode"). The *exclusio* principle has been widely criticized. *See, e.g.*, SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 350-51 (1943); Matheson v. Ambrust, 284 F.2d 670, 674 (9th Cir. 1960), *cert. denied*, 365 U.S. 870 (1961); HART & SACKS, THE LEGAL PROCESS 1173-74 (temp. ed. 1958); 2A SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 47.25 (4th ed. C. Sands 1973) [hereinafter cited as SUTHERLAND]; Note, *Implying Civil Remedies From Federal Regulatory Statutes*, 77 HARV. L. REV. 285, 290-91 (1963).

[92] 414 U.S. at 458; *see* Neuberger v. Commissioner, 311 U.S. 83, 88 (1940). The legislative history of the Rail Passenger Service Act of 1970 disclosed a congressional intent to deny private actions that the Act did not specifically authorize. 414 U.S. at 461-62. The *Amtrak* Court therefore applied the *exclusio* doctrine to deny the implied remedy. *See id.*

rights of action in *Cort v. Ash*.[93] *Cort* established a four-factor test for determining whether an implied right exists under a statute.[94] Under the first *Cort* factor, a court must ascertain whether the plaintiff is a member of the class for whose special benefit Congress enacted the federal statute.[95] The second *Cort* factor requires an examination of the statute's legislative history to determine whether Congress intended explicitly or implicitly to create or deny a private cause of action.[96] The third *Cort* inquiry requires a court to decide whether an implied private right is consistent with the underlying purpose of the legislative scheme.[97] Finally, the court must determine if the cause of action is one traditionally relegated to state law.[98] The Supreme Court strictly applied each criterion in *Cort* and created a presumption against implication.[99] The Court failed to specify, however, whether the four factors were of equal weight and whether all the factors must be satisfied before a court should imply a private remedy.

During the 1979 term, the Supreme Court further refined and restricted its approach toward the implication of private remedies. In *Cannon v. University of Chicago*,[100] the Court implied a private remedy under Title IX of the Education Amendments of 1972.[101] The Court focused on the first *Cort* factor, reasoning that the "right or duty-creating" language of a statute is the most accurate indicator of whether a court should imply a private right of action.[102] The Court held that a private right of action should be implied only when the language of the statute explicitly conferred a right directly on a specific class that included the plaintiff.[103] In emphasizing this point, the Court explicitly

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[93] 422 U.S. 66 (1975).

[94] *Id.* at 78.

[95] *Id.*; *see* Texas & Pac. Ry. v. Rigsby, 241 U.S. 33, 39 (1916). Decisions prior to *Cort* had not limited implication to plaintiffs who were the principal beneficiaries of a statute. *E.g.*, Wyandotte Transp. Co. v. United States, 389 U.S. 191, 201 (1967); J.I. Case Co. v. Borak, 377 U.S. 426, 431-32 (1964).

[96] 422 U.S. at 78; *see Amtrak*, 414 U.S. 453, 458 (1974). In *Cort*, the Court stated when the statute grants certain rights to a class of persons including the plaintiff, the statute's legislative history need not show an intent to create a private action to permit implication. 422 U.S. at 82. An explicit legislative intent to deny a private action would, however, be controlling. *Id.*

[97] 422 U.S. at 78; *see* Securities Inv. Protection Corp. v. Barbour, 421 U.S. 412, 423 (1975); *Amtrak*, 414 U.S. 453, 458 (1974).

[98] 422 U.S. at 78.

[99] *Id.* at 79-85; *see* Note, *Implication of Private Actions from Federal Statutes: From* Borak *to* Ash, 1 J. CORP. L. 371, 387 (1976).

[100] 441 U.S. 677 (1979).

[101] *Id.* at 717.

[102] *Id.* at 690 n.13. In addition to defining the first *Cort* factor, the *Cannon* Court appeared to note the demise of the *Amtrak* Court's *exclusio* principle. *See* 441 U.S. at 711; note 91 *supra*. *But see* text accompanying note 131 *infra*. The *Cannon* Court found that the existence of express remedies in a complex legislative framework was not "sufficient reason for refusing to imply an otherwise appropriate remedy under a separate section." 441 U.S. at 711.

[103] 441 U.S. at 690 n.13.

stated that statutes creating duties for the benefit of the public at large do not evidence congressional intent to create a private cause of action.[104]

In *Touche Ross & Co. v. Redington*,[105] the Supreme Court modified the *Cort* test and reaffirmed its restrictive posture toward implied private rights of action under federal securities laws. In considering whether to imply a private right under section 17(a) of the '34 Act, the *Redington* Court focused on the first three *Cort* factors, since those factors are the traditional indicia of legislative intent.[106] The Court considered whether plaintiffs were members of the class sought to be protected by section 17(a),[107] the language[108] and the legislative history of the section,[109] and the statutory scheme of the '34 Act.[110] Since analysis of the first three *Cort* factors failed to disclose legislative intent to provide a private remedy under section 17(a), the Court declined to consider whether the private remedy sought was traditionally relegated to state law.[111] The *Redington* Court thus indicated for the first time that the four elements of the *Cort* test do not deserve equal weight.[112] The Court concluded that the primary consideration is whether Congress intended to create a private right of action.[113]

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[104] *Id.* In *Cannon*, the Court noted that its previous implication of a private right of action under § 10(b) of the '34 Act had not followed the general pattern of refusing to imply a private right under a statute creating duties for the benefit of the public at large. *Id.; see* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) (recognition of § 10(b) private cause of action). The *Cannon* Court found that widespread lower court acceptance of an implied right of action under § 10(b) was the cause of the deviation. 441 U.S. at 690 n.13.

[105] 442 U.S. 560 (1979).

[106] *Id.* at 568-74.

[107] *Id.* at 569-71. Section 17(a) of the '34 Act expressly protects investors. *Id.* at 569. The term "investors" includes only purchasers and sellers of securities. *Id.* at 574. Since the *Redington* plaintiffs were neither purchasers nor sellers of securities, the Supreme Court concluded that the plaintiffs were not members of the class sought to be protected by § 17(a). *Id.* at 576.

[108] *Id.* at 568-71. The *Redington* Court concluded that the language of § 17(a) of the '34 Act did not purport to create a private right of action. *Id.* at 571. Section 17(a) contained no prohibition on which to found an implied right of action. *Id.* at 569.

[109] *Id.* at 571. The legislative history of the '34 Act is silent on the availability of a private remedy under § 17(a). *Id.* Since the statutory language weighed against implication, *see* note 108 *supra*, the *Redington* Court interpreted the absence of legislative history as a further indication of congressional intent to deny an implied private right of action. 442 U.S. at 571.

[110] 442 U.S. at 571. The *Redington* Court, in accordance with the third *Cort* factor, examined the legislative scheme of the '34 Act. *Id.* The Court recognized that implied rights under § 17(a) were inconsistent with the framework of the '34 Act. *Id.* at 571-74; *see* text accompanying notes 131-34 *infra*.

[111] 442 U.S. at 575-76.

[112] *Id.*

[113] *Id.* at 575-77. The *Redington* Court observed that the judiciary should not imply a private remedy without adequate evidence of congressional intent to infer that private right. *Id.* at 574. The Court reasoned that a contrary position would infringe upon Congress' legislative power. *Id.* at 577-79.

The Supreme Court further narrowed the focus of the *Cort* test in *Transamerica Mortgage Advisors, Inc. v. Lewis*.[114] In *Transamerica*, the Court implied a private right of action under section 215 of the Investment Advisors Act of 1940, but refused to accept the plaintiff's implication claim under section 206.[115] The Court premised its analysis of the implication issues upon basic statutory construction.[116] The Court emphasized that the appropriate inquiry is whether Congress intended to create the private cause of action asserted.[117] Accordingly, the *Transamerica* Court selected the second *Cort* factor as the initial inquiry under its implication analysis.[118] Following *Redington*, the *Transamerica* Court reorganized the second prong of the *Cort* test to include examination of statutory language and legislative history.[119] If neither language nor legislative sources reveal a congressional intent to imply a private right of action, the inquiry ends with a denial of private rights.[120] Once the statute satisfies the initial level of the modified *Cort* test, a court must consider the third *Cort* factor to determine whether implying a private right is consistent with the purpose of the statute.[121] When the foregoing factors indicate that Congress did not intend to imply a private right of action, a court does not need to consider the fourth *Cort* factor.[122] The determination of whether an adequate state remedy exists, however, remains a part of the modified *Cort* test if the statute satisfies the preceding factors.[123] The *Transamerica* decision, therefore, reorders and redefines the original *Cort* factors to create a more restrictive implication test.

Taken together, *Redington* and *Transamerica* indicate that the Supreme Court has adopted a two-step test for determining whether to imply a private right of action.[124] A court should consider initially whether Congress intended to create a private remedy in favor of the plaintiff.[125] In determining legislative intent, the court should examine

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[114] 444 U.S. 11 (1979).

[115] *Id.* at 23-24.

[116] *Id.* at 16.

[117] *Id.*

[118] *Id.* at 15-17.

[119] *Id.* at 16-22; *see* notes 108-09 *supra*. Originally, the Court examined only the legislative history of a statute under the second *Cort* factor to determine whether Congress intended to provide a private remedy. Cort v. Ash, 422 U.S. at 78. The *Transamerica* Court recognized that congressional intent may be implicit in the structure of a statute or the circumstances of its enactment. 444 U.S. at 18.

[120] 444 U.S. at 23-24.

[121] *Id.; see* note 128 *infra*.

[122] 444 U.S. at 23-24. The *Transamerica* Court rejected the plaintiffs' argument that a court must always consider the fourth *Cort* factor and reiterated that the *Cort* factors are not of equal weight. *Id.*; Touche Ross & Co. v. Redington, 442 U.S. at 575-76.

[123] 444 U.S. at 23-24.

[124] *See id.* at 24; Touche Ross & Co. v. Redington, 442 U.S. at 575-76.

[125] 444 U.S. at 24; 442 U.S. at 575-77.

whether the statute creates a distinct federal right in the plaintiff[126] and whether the legislative history and language of the statute indicate that Congress intended to provide a private remedy.[127] The court should determine also whether implication of a private right of action would be consistent with the legislative scheme.[128] If the court's legislative intent analysis indicates that Congress did not intend to provide a private remedy, the court should not imply a private right of action.[129] If Congress intended to create a private remedy, however, the court should determine further whether implication of a federal remedy would be inappropriate given traditional state law coverage of defendant's alleged conduct.[130]

In attempting to discern the now-critical element of legislative intent, the Supreme Court has indicated that the presence of an express remedy in other sections of a statute is significant. In *Redington* and *Transamerica*, the Court apparently has resurrected the *Amtrak* Court's restrictive *exclusio* principle of statutory construction.[131] In *Redington*,

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[126] Cannon v. University of Chicago, 441 U.S. 677, 689-94 (1979); *see* text accompanying notes 102-04 *supra*.

[127] 444 U.S. at 18; 442 U.S. at 568-71; *see* notes 108-09 and 119 *supra*.

[128] 442 U.S. at 575-76. The Court has wavered on the question whether implication must be "necessary" to the accomplishment of the legislative objective or merely "consistent" with the purpose of the statutory scheme. *Compare* Cannon v. University of Chicago, 441 U.S. at 703 ("necessary or at least helpful") *and* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 39-41 (1977) ("necessary") *with* Cort v. Ash, 422 U.S. 66, 78 (1975) ("consistent"). The better view is that the Court's occasional concern with the "necessity" of a remedy is directed generally toward the feasibility of implication, rather than specifically toward the third *Cort* factor. *See* Steinberg, *Implied Private Rights of Action Under Federal Law*, 55 NOTRE DAME LAW. 33, 48 (1979) [hereinafter cited as Steinberg]. The legislative intent inherent in the statutory scheme will often differ from the statute's broad legislative objectives. *Id.* The Supreme Court's current emphasis on legislative intent, rather than on furthering a statute's remedial purposes, indicates that the Court has modified the third *Cort* factor to require an examination of the statutory scheme. *See* 442 U.S. at 571, 574-75; text accompanying notes 131-35 *infra*.

[129] 444 U.S. at 24; 442 U.S. at 575-76.

[130] 442 U.S. at 575-76; Cort v. Ash, 422 U.S. at 78.

[131] 444 U.S. at 19; 442 U.S. at 572. *Redington* and *Transamerica* revived the *exclusio* doctrine from its apparent demise in *Cannon*. *See* Steinberg, *supra* note 128, at 47-48; note 102 *supra*.

The Supreme Court also has adopted reasoning similar to the *exclusio* principle in two recent decisions limiting the scope of an implied right of action under § 10(b) of the '34 Act. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), and Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Court based its decisions primarily on the plain language of § 10(b). 425 U.S. at 199 (§ 10(b) applies only to willful and knowing acts); 421 U.S. at 732-33 (§ 10(b) standing limited to purchasers or seller of securities). The Supreme Court buttressed its conclusion in *Blue Chip Stamps*, however, by emphasizing that the express liability provisions of the '33 and '34 Acts were limited to purchasers and sellers of securities and were enacted contemporaneously with § 10(b). 421 U.S. at 736. The Court reasoned that Congress could not have intended to create a broader class of plaintiffs in an implied right of action than it had created under the express liability sections. *Id.* In *Hochfelder*, the Court refused to exend the § 10(b) implied action to negligent conduct,

the Supreme Court used the maxim to bolster its decision to not imply a private remedy under section 17(a) of the '34 Act.[132] The Court found that the existence of an express remedy in another section, together with the absence of contrary legislative intent, allowed rejection of an implied private right of action.[133] The Court indicated its extreme reluctance to infer a private right of action from a statute if that inference would permit a plaintiff to avoid the substantive requirements of an express liability provision in the same statute.[134] More recently, the *Transamerica* Court instructed that a court should be "chary" of reading an implied remedy into a statute already providing an express remedy.[135]

The Court's current implication analysis thus requires a policy of special caution when considering whether to imply a private right of action for conduct proscribed by an express remedy. The Court's approach is designed to ascertain whether Congress intended to create a private cause of action under a statute.[136] Express liability provisions elsewhere in a statute apparently are an indication that Congress did not intend to create a private right of action under another section.[137] Given the relative lack of elaboration in the Supreme Court's opinions, however, the lower federal courts have been free to formulate their own approaches to implication. A review of several of the most recent decisions indicates that lower courts have vastly different approaches to implementing the Supreme Court's directive.

In *Ross v. A. H. Robins Co.*,[138] the Second Circuit recently adopted a "nullification" approach and held that the existence of an express remedy under section 18 of the '34 Act does not preclude implication of a section 10(b) private right of action.[139] In *Ross*, the plaintiffs claimed that the A.H. Robins Co. and its directors made material misstatements and omissions about the safety and effectiveness of the "Dalkon Shield," a

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noting that the express provisions of the '33 Act proscribing negligent misconduct contain strict procedural requirements that could be negated if § 10(b) gave rise to an implied action for negligence. 425 U.S. at 210.

[132] *See* 442 U.S. 572.

[133] *Id.* The status of § 18(a) of the '34 Act as the "catch-all" liability provision for violations of the Act's reporting requirements encouraged rejection of the § 17(a) implied remedy in *Redington*. *See id.* at 573-74.

[134] 442 U.S. at 572. In *Redington*, the Court reaffirmed its conviction that the inclusion of an express remedy in the statute indicated that Congress knew how to include a remedy and did so when it intended one to exist. *Id.* (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. at 734).

[135] 444 U.S. at 19. The *Transamerica* Court expressly cited the *exclusio* doctrine as one reason for not implying a private right of action under § 206 of the Investment Advisors Act. *Id.* at 19-20 (citing *Amtrak*, 414 U.S. at 458; Botany Worsted Mills v. United States, 278 U.S. at 289).

[136] *See* text accompanying notes 124-30 *supra*.

[137] *See* text accompanying notes 131-35 *supra*.

[138] 607 F.2d 545 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980).

[139] *See id.* at 556.

birth control device manufactured and marketed by Robins.[140] Robins' annual report, year-end financial report, and a stock prospectus contained the alleged misrepresentations.[141] The plaintiffs charged that the misrepresentations artificially inflated the prices of the company's securities,[142] and sought relief under section 10(b) and rule 10b-5.[143]

Although the *Ross* plaintiffs sued under rule 10b-5, section 18 would have provided an express cause of action for the defendants' conduct since the alleged misrepresentations appeared in documents filed with the SEC.[144] The district court dismissed the complaint, holding that Congress intended section 18 to be the exclusive remedy for conduct proscribed by that section.[145]

On appeal, the Second Circuit reversed the trial court and concluded that private plaintiffs may proceed under rule 10b-5 for misrepresentations in documents filed with the SEC.[146] In analyzing whether section 18 is an exclusive remedy, the court declined to employ the Supreme Court's methodology for determining legislative intent in implied private right of action cases.[147] The *Ross* court reasoned that the Supreme Court's analytical framework was inapplicable[148] because courts already recognize an implied right of action under section 10(b).[149] The court then examined several recent Supreme Court decisions, and rejected the plaintiffs' contention that remedies in the securities acts never are exclusive.[150] Instead, the court adopted a "nullification" test

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[140] *Id.* at 547-50. The *Ross* plaintiffs alleged that the defendants recklessly disregarded information indicating the inaccuracy of statements concerning the effectiveness of the Dalkon Shield and that the defendants predicated their misrepresentations upon insufficient test data. *Id.* at 548-49. Additionally, the plaintiffs alleged that the defendants failed to correct their misrepresentations in a timely fashion. *Id.* at 550.

[141] *Id.* at 549. The plaintiffs in *Ross* alleged that the defendants' misrepresentations appeared in several press releases as well as in documents filed with the SEC. *Id.* Material misrepresentations in press releases give rise to rule 10b-5 liability. Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 97-98 (10th Cir. 1971). Presumably, then, the Second Circuit did not need to address the exclusiveness of the § 18 remedy.

[142] 607 F.2d at 550. Subsequent to public disclosure of Dalkon Shield's ineffectiveness and safety problems, the value of A.H. Robins Co. stock dropped from $19 to $13 share on the New York Stock Exchange. *Id.*

[143] *Id.*

[144] *Id.* at 553; *see* text accompanying notes 60-61 *supra.*

[145] Ross v. A.H. Robins Co., 465 F. Supp. 904, 913 (S.D.N.Y. 1979). The district court in *Ross* analyzed the '34 Act's legislative scheme in holding that § 18 precludes that use of § 10(b). *Id.* The district court reasoned that the procedural and substantive requirements of § 18 manifested Congress' intention that § 18 serve as an exclusive remedy. *Id.*

[146] 607 F.2d at 555, 559; *see* text accompanying notes 153-67 *infra.*

[147] 607 F.2d at 553; *see* text accompanying notes 124-30 *supra.*

[148] 607 F.2d at 553.

[149] *Id.; see* note 3 *supra.*

[150] 607 F.2d at 554. The *Ross* plaintiffs relied on the Supreme Court's decision in SEC v. National Secs. 5, Inc., 393 U.S. 453, 468 (1969), as authority for the proposition that Congress intended the remedies in the securities acts to overlap. 607 F.2d at 554. In *National Securities*, the Court held that an overlap between § 10(b) and § 14 of the '34 Act does not

which prohibits plaintiffs from invoking an implied remedy if the terms of the implied remedy unjustifiably nullifies the procedural and substantive limitations of the competing express remedy.[151] The *Ross* court reasoned that allowing an implied remedy where nullification exists would encourage circumvention of the carefully drawn express remedies included in the securities acts.[152]

The Second Circuit began its analysis by noting that plaintiffs seeking to establish reliance on misrepresentations face a more difficult task under section 18 than under section 10(b).[153] In a rule 10b-5 action, courts presume reliance once a plaintiff establishes materiality[154] or proves that the material misrepresentations affected the open market price of the stock.[155] Under section 18, the plaintiff must plead and prove actual reliance on the misrepresentation in purchasing or selling a security.[156]

The Second Circuit next reasoned that the plaintiff's burden of establishing scienter[157] under section 10(b) offsets the relative advantage of not having to prove actual reliance.[158] Under rule 10b-5, the plaintiff has the burden of averring specific facts which imply that the defendant acted with scienter.[159] Under section 18, however, a plaintiff states a cause of action merely by showing that a document filed with the SEC contained a misrepresentation and that the plaintiff relied on the misrepresentation.[160] The *Ross* court found that this burden of proof allocation adversely affects section 10(b) claims since plaintiffs may have

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limit either remedy. 393 U.S. at 468. The *Ross* court recognized that recent Supreme Court decisions have abrogated the liberal philosophy of *National Securities*. 607 F.2d at 554; *see* text accompanying notes 132-35 *supra*.

[151] 607 F.2d at 553.

[152] *Id.* at 554-55.

[153] *Id.* at 552-53.

[154] *See* text accompanying note 75 *supra*.

[155] *See* text accompanying note 76 *supra*.

[156] *See* text accompanying note 61 *supra*.

[157] *See* text accompanying note 73 *supra*.

[158] 607 F.2d at 556.

[159] Denny v. Barber, 576 F.2d 465, 470 (2d Cir. 1978); Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 521-22 (10th Cir.), *cert. denied*, 414 U.S. 874 (1973). In *Ross*, the Second Circuit held that the plaintiffs' complaint failed to allege the specific facts necessary to raise the inference of scienter. 607 F.2d at 558. The court found that the plaintiffs failed to allege facts showing that the defendants were aware of information which raised serious doubts about the safety and effectiveness of the Dalkon Shield. *Id.* The *Ross* court also found that the plaintiffs failed to allege when the defendants became aware of the defects in the product. *Id.* Finally, the complaint failed to specify the time period during which the price of Robins' stock fell. *Id.* at 559. The Second Circuit remanded *Ross* with instructions that the district court provide the plaintiffs leave to amend. *Id.*

[160] Gross v. Diversified Mortgage Investors, Inc., 438 F. Supp. 190, 195 (S.D.N.Y. 1977); 3 Loss, *supra* note 8, at 1752. Technically, § 18 requires that a defendant act with scienter, but the Supreme Court allows a presumption of the requisite mental state once a plaintiff establishes a prima facie case. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211 n.31 (1976). The burden in a § 18 action is on the defendant to prove the absence of scienter. *See* note 63 *supra*.

difficulty alleging the specific facts necessary to survive a motion to dismiss.[161] The Second Circuit thus concluded that defrauded investors enjoy no substantive advantages by proceeding under section 10(b) rather than under the express remedy of section 18.[162]

The *Ross* court also relied on policy considerations in holding that section 18 is not an exclusive remedy. Initially, the court stated that predicating the availability of rule 10b-5 upon misrepresentations in an SEC filing might deny all remedies to some investors.[163] Finding that open market investors have become one of the chief beneficiaries of rule 10b-5 protection,[164] the Second Circuit reasoned that the current Congress would not condone basing rule 10b-5 liability on such a delineation.[165] Additionally, the court speculated that forcing plaintiffs to proceed under section 18 rather than under section 10(b) would encourage officers and directors to incorporate their misrepresentations in documents filed with the SEC.[166] The Second Circuit reasoned that such incorporation would insulate these potential defendants from section 10(b) liability since once the misrepresentations appeared in an SEC filing, section 18 would become the only available remedy.[167]

In *Wachovia Bank and Trust Co. v. National Student Marketing Corp.*,[168] the Circuit Court of Appeals for the District of Columbia (D.C. Circuit) recently combined a "legislative intent" approach with the *Ross* "nullification" test, in resolving a section 10(b) implication question.[169] The D.C. Circuit held that a court may imply a section 10(b) private right of action for conduct proscribed by sections 11 and 12 of the '33 Act and section 18 of the '34 Act.[170] In *Wachovia*, the plaintiffs sought damages to remedy losses suffered when the value of National Student Marketing Corp. (NSMC) stock dropped dramatically soon after the plaintiffs purchased a large quantity of NSMC stock.[171] The plaintiffs charged the defendants with conspiracy to defraud investors by artificially inflating

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[161] 607 F.2d at 556.

[162] *Id.* The *Ross* court failed to address the impact of the procedural requirements in § 18. *See* text accompanying notes 275-85 *infra*.

[163] 607 F.2d at 556. Currently, many plaintiffs seek relief under rule 10b-5 for misstatements in SEC filings because of an inability to satisfy the substantive or procedural requirements of § 18. *See* 5 JACOBS, *supra* note 30, § 3.02[h], at 1-106. Thus, denying those plaintiffs a remedy under rule 10b-5 effectively would preclude litigation of their claims under the federal securities laws. 607 F.2d at 556.

[164] 607 F.2d at 556; Thill Securities Corp. v. NYSE, 433 F.2d 264, 273 (7th Cir. 1970); *cf.*, United States v. Naftalin, 441 U.S. 768, 775 (1979) (investors not exclusive beneficiaries of '34 Act).

[165] 607 F.2d at 556.

[166] *Id.*

[167] *Id.*

[168] [1980 Transfer Binder] FED. SEC. L. REP (CCH) ¶ 97,712 (D.C. Cir. 1980).

[169] *See id.* at 98,730-37.

[170] *Id.* at 98,737.

[171] *Id.* at 98,726.

the price of NSMC stock.[172] Specifically, plaintiffs contended that misrepresentations about NSMC's financial condition appeared in oral statements, press releases, published reports, and reports filed with the SEC.[173] The plaintiffs sought relief under section 10(b) of the '34 Act.[174]

The defendants moved to dismiss the plaintiffs' action, claiming that the express remedies of the securities acts precluded any implied right of action for private plaintiffs under section 10(b).[175] The defendants asserted that section 18 of the '34 Act provided the plaintiffs a remedy, since most of the alleged misstatements appeared in documents filed with the SEC.[176] The defendants contended that the plaintiffs had an express remedy under section 12(2) of the '33 Act for misstatements contained in documents not filed with the SEC.[177] The district court held that the plaintiffs did not have adequate remedies under either section 18(a)[178] or section 12(2),[179] and concluded that plaintiffs had stated a claim under section 10(b) of the '34 Act.[180]

On appeal, the D.C. Circuit affirmed the trial court's finding of an implied private right of action under section 10(b) of the '34 Act.[181] The *Wachovia* court adopted a two-part approach. First, the court examined whether an implied right of action generally exists under section 10(b).[182]

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[172] *Id.* at 98,727. *Wachovia* defendants included National Student Marketing Corp. (NSMC) and several of its officers and employees. *Id.* The plaintiffs also sued NSMC's independent auditor, several of the auditor's employees, and NSMC's outside counsel. *Id.* Plaintiffs settled with NSMC and various named defendants. *Id.*

[173] *Id.*

[174] *Id.* In addition to the § 10(b) claim, the *Wachovia* plaintiffs sought relief under § 17(a) of the '33 Act, and §§ 13(a) and 14(a) of the '34 Act. *Id.*

[175] Wachovia Bank & Trust Co. v. National Student Marketing Corp., 461 F. Supp. 999, 1003 (D.D.C. 1978).

[176] *Id.* at 1005.

[177] *Id.*

[178] *Id.* at 1005-06. The *Wachovia* plaintiffs did not allege reliance upon documents filed with the SEC. *Id.* Reliance upon documents filed with the SEC is critical to a claim under § 18(a). *Id.; see* text accompanying note 61 *supra.*

[179] 461 F. Supp. at 1006. Section 12(2) applies to negligent misstatements and omissions. *Id.; see* text accompanying note 30 *supra.* The district court found that victims of intentional fraud should not be limited to the negligence remedy in § 12(2). 461 F. Supp. at 1006. The court also noted that § 12(2) did not apply because the present defendants were not "sellers" of the securities. *Id.; see* text accompanying note 32 *supra.*

[180] 461 F. Supp. at 1007. The district court ultimately dismissed the plaintiffs' § 10(b) action as untimely. *Id.* at 1013. The court ruled that the private action under § 10(b) of the '34 Act was subject to the two-year statute of limitations period found in the District of Columbia blue sky law. *Id.* at 1007-08.

[181] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,737. The D.C. Circuit reversed the district court's holding that the two-year period under the jurisdiction's blue sky law was the appropriate statute of limitations. *Id.* The circuit court found that the plaintiffs' action was not time-barred under the District's applicable three-year limitations period for general fraud claims. *Id.*

[182] *See id.* at 98,730-33; text accompanying notes 184-94 *infra.*

Finding that Congress intended to create an implied right of action under section 10(b), the *Wachovia* court next analyzed whether the existence of express remedies elsewhere in the securities act required the rejection of an implied remedy.[183]

The *Wachovia* court began its analysis by attempting to ascertain Congress' intent in enacting the securities acts. Applying the *Cort* four-factor test,[184] the D.C. Circuit first found that section 10(b) was designed to benefit an "especial class" composed of investors.[185] The plaintiffs were members of the broad investor class.[186] The court next examined legislative history for evidence that Congress intended to imply a remedy under section 10(b).[187] Finding no clear legislative history of an intent to imply the remedy, the court searched for indications that Congress meant to deny an implied remedy under section 10(b).[188] Failing to find a legislative intent to deny the implied remedy, the *Wachovia* court considered whether a private remedy under section 10(b) was necessary or helpful to accomplish the statutory purpose.[189] The court found that the implied remedy was at least helpful in enforcing the remedial purposes of the securities acts.[190] While noting the relative lack of importance of the fourth *Cort* factor in ascertaining legislative intent, the D.C. Circuit found that the federal securities acts traditionally controlled fraudulent conduct with national implications.[191] Application of the *Cort* criteria convinced the court of Congress' implicit intent that a private cause of action exists under section 10(b).

As an additional aid in ascertaining legislative intent, the *Wachovia* court looked to the history of implication under section 10(b).[192] The D.C.

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[183] *See* [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,733-36; text accompanying notes 195-202 *infra*.

[184] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,731. The D.C. Circuit in *Wachovia* stated that recent Supreme Court decisions centered on the application of the *Cort* factors. *Id.* n.22; *see* text accompanying notes 93-99 *supra*. *But see* Cannon v. University of Chicago, 441 U.S. 677, 742 (1979) (Powell, J., dissenting) (*Cort* test should be discarded); Comment, *Implied Rights of Action in Federal Legislation: Harmonization Within the Statutory Scheme*, 1980 DUKE L.J. 928, 934 n.26 (noting strong indications that Supreme Court no longer considers *Cort* test restrictive enough).

[185] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,731.

[186] *Id.*

[187] *Id.*

[188] *Id.* at 98,731-32. The *Wachovia* court interpreted *Transamerica* to require judicial consideration of whether Congress meant to deny a remedy, in the likely event that legislative history was silent regarding implication. *Id.*

[189] *Id.* at 98,732; *see* Cannon v. University of Chicago, 441 U.S. 677, 703 (1979).

[190] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,732. The *Wachovia* court reasoned that an implied right of action under § 10(b) assists in enforcing the remedial purposes of the securities acts by relieving the SEC's enforcement burden and deterring fraud. *Id.*; *see* J.I. Case Co. v. Borak, 377 U.S. 426, 432-33 (1964) (burden on SEC is justification for implication under § 14(a)); Fratt v. Robinson, 203 F.2d 627, 631 (9th Cir. 1953) (§ 10(b) assists in deterring fraud).

[191] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,732.

[192] *Id.* at 98,731 and 98,736-37.

Circuit concluded that the well-established status of the implied private right of action favored implication in the instant case.[193] The court indicated that if Congress did not intend to imply a private remedy under section 10(b), Congress since would have limited or constricted judicial application of implied remedies under that section.[194]

Finding that Congress intended to create an implied right of action under section 10(b), the D.C. Circuit next considered whether a private right of action should be implied under section 10(b) when other sections of the '33 and '34 Acts provide express remedies.[195] The court indicated that remedies among the securities acts may freely overlap,[196] except when implication would result in nullification of express remedies.[197] The court examined the express remedies of the '33 and '34 Acts, none of which were available to the plaintiffs in *Wachovia*,[198] and determined that the remedies were totally different from the remedy implied under section 10(b).[199] The court noted that the remedies expressly provided by sections 11 and 12 of the '33 Act are not inconsistent with an implied right of action under section 10(b).[200] The *Wachovia* court found that the burden of proving scienter, rather than mere negligence, under section 10(b) counteracts the procedural restrictions of sections 11 and 12.[201] Relying on *Ross*, the court also found that the plaintiff's burden of establishing scienter under section 10(b) offsets the plaintiff's burden of proving actual reliance under section 18.[202] Thus, the D.C. Circuit held that implication does not nullify the express remedies of the '33 and '34 Acts, since defrauded investors are not substantially advantaged by proceeding under section 10(b) of the '34 Act.

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[193] *Id.* at 98,731.

[194] *Id.* at 98,736-37.

[195] *See id.* at 98,733-36.

[196] *Id.; see* SEC v. National Secs., Inc., 393 U.S. 453, 468 (1969) (overlap between §§ 10(b) and 14(a) of '34 Act does not limit either remedy). The *Wachovia* court distinguished Touche Ross & Co. v. Redington, 442 U.S. 560 (1979), in which the Supreme Court expressed its extreme reluctance to imply a remedy when the statute already provided express remedies. [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,734 n.29; *see* text accompanying notes 132-34 *supra*. The D.C. Circuit noted that the Supreme Court expressly declined to settle the "overlap" issue in *Redington*. [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,734 n.29; *see* 442 U.S. at 574. The court further reasoned that, unlike *Redington*, the legislative history in *Wachovia* did not indicate that the express remedies were intended to be exclusive. [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,734 n.29; *see* 442 U.S. at 573.

[197] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,734 (citing Ernst & Ernst v. Hochfelder, 425 U.S. at 208-11; Blue Chip Stamps v. Manor Drug Stores, 421 U.S. at 736).

[198] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,736; *see* text accompanying notes 178-79 *supra*.

[199] [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,734.

[200] *Id.* at 98,734-35.

[201] *Id.*

[202] *Id.* at 98,735-36.

Unlike the *Ross* and *Wachovia* courts, the United States District Court for the Northern District of California recently adopted a "strict construction" approach to implication in *McFarland v. Memorex.*[203] Using this approach, the court held that the existence of an express remedy under section 11 or 12 of the '33 Act foreclosed implication of a section 10(b) private right of action for conduct covered by those sections.[204] In *McFarland*, the plaintiff claimed that defendants[205] committed fraud, negligence, and other breaches of duty in connection with the offer and sale of common stock of Memorex Corporation under a registration statement and prospectus.[206] Plaintiff sought relief under various provisions of the securities acts, including sections 11 and 12 of the '33 Act and section 10(b) of the '34 Act and rule 10b-5.[207]

After analyzing the sufficiency of the complaint,[208] the *McFarland* court carefully examined the plaintiff's alleged private right of action. The court's analysis represents a concerted effort to follow the recent policy directives of the Supreme Court.[209] The district court indicated that congressional intent is the critical factor in determining whether to imply a private right of action, rather than the consideration of whether

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[203] 493 F. Supp. 631, 653-55 (N.D. Cal. 1980).

[204] *Id.* at 655.

[205] The defendant class in *McFarland* included the Memorex Corporation, which issued the stock, the underwriters, the officers and/or directors of Memorex at the time of the stock offering, the certified public accountants who certified Memorex' annual Consolidated Statements of Operation, and the persons and entities that sold warrants to purchase Memorex stock to the underwriters prior to the offering. *Id.* at 634-35.

[206] *Id.* at 634. The *McFarland* plaintiff alleged that the defendants collectively were responsible for false statements and omissions in the prospectus and registration statement filed with the SEC. *Id.* at 635. Specifically, the plaintiff alleged that the defendants misrepresented the financial condition, net earnings, assets, and net worth of Memorex, attempted to conceal the company's materially poor operating results for the third quarter of 1978, and misrepresented that the financial statements in the prospectus and registration statement fairly depicted Memorex' financial condition and operating results. *Id.* at 635-36.

[207] *Id.* at 634. The *McFarland* plaintiff alleged violations of §§ 11, 12, 15 and 17 of the '33 Act, as well as §§ 10(b), 18(a), and 20 of the '34 Act. *Id.*

[208] The *McFarland* court held initially that the plaintiff's complaint lacked the requisite particularity to state circumstances constituting fraud. *Id.* at 636; *see* FED. R. CIV. PRO. 9(b). After dismissing the complaint, the court analyzed the alleged section violations to determine whether the defects in the complaint were curable. 493 F. Supp. at 640; *see* Barry v. St. Paul Fire & Marine Ins. Co., 555 F.2d 3, 13 (1st Cir. 1977), *aff'd*, 438 U.S. 531 (1978) (courts liberally allow plaintiff to replead after complaint dismissed under FED. R. CIV. PRO. 9(b)). The district court determined that only the Memorex directors and the non-director officers who signed the registration statement were subject to potential liability under § 11 of the '33 Act. 493 F. Supp. at 642-47; *see In re* Gap Stores Secs. Litigation, 457 F. Supp. 1135, 1143 (N.D. Cal. 1978) (non-signing officers not liable under § 11); *In re* Equity Funding Corp. of Am. Sec. Litigation, 416 F. Supp. 161, 181 (C.D. Cal. 1976) (officers not liable under § 11 for aiding and abetting other wrongdoers); note 19 *supra*. The court also found that only the underwriters were potentially liable under § 12 of the '33 Act. 493 F. Supp. at 643; *see* Collins v. Signetics Corp., 605 F.2d 110, 111-12 (3d Cir. 1979) (stock purchaser may bring § 12 action only against immediate seller); note 32 *supra*.

[209] *See* text accompanying notes 124-30 *supra*.

implication will further the remedial purposes of the securities acts.[210] The court applied rules of strict construction and refused to imply a remedy unless Congress intended that a remedy exist when it adopted a particular provision.[211] The *McFarland* court observed that when an express remedy potentially is available to the plaintiff, a court should imply a private right of action under another section only if Congress has declared an intent to afford multiple remedies for the same wrong.[212]

Applying this intent-oriented approach to the facts in *McFarland*, the court found that Congress did not intend to create an implied remedy under section 10(b) and rule 10b-5 when express remedies are available through provisions in the '33 Act.[213] The plaintiff in *McFarland* had potential rights of action under sections 11 and 12(2) of the '33 Act.[214] The court found that implication of a private right of action under the broad dictates of the '34 Act would imply a congressional intent to ignore the procedural restrictions carefully placed on express remedies in the '33 Act.[215] The court refused to impute such intentional cancellation to the actions of the Congress in enacting the '34 Act.[216] Instead, the *McFarland* court in effect found that the burden of provin'; congressional intent to provide for multiple remedies had shifted to the plaintiff upon the finding that express remedies were available.[217] Finding no express congressional intent to provide for multiple remedies, the court refused to imply a private right of action under section 10(b).[218]

The *Ross*, *Wachovia*, and *McFarland* approaches to implying a private right under section 10(b) are inadequate. The lower court ap-

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[210] 493 F. Supp. at 640-41; *see* Touche Ross & Co. v. Redington, 442 U.S. 560, 578 (1979) (ultimate question is congressional intent, rather than whether court thinks it can improve upon statutory scheme).

[211] 493 F. Supp. at 640.

[212] *Id.* at 655.

[213] *Id.* The *McFarland* court viewed the widespread acceptance of the § 10(b) implied remedy as a consequence of history, rather than an indication that Congress had intended to create a remedy under that section. *Id.* at 654-55; *see* Touche Ross & Co. v. Redington, 442 U.S. 560, 577 n.19 (1979) (Supreme Court recognition of § 10(b) implied remedy was mere acquiesence in 25-year acceptance by lower courts); Cannon v. University of Chicago, 441 U.S. 667, 690-93 n.13 (1979) (same).

[214] *See* note 208 *supra*.

[215] 493 F. Supp. at 655.

[216] *Id.*

[217] *See id.*

[218] *Id.* at 655. Because of prior Ninth Circuit decisions, the *McFarland* court declined to prevent a § 10(b) cause of action at such an early stage of the litigation. *Id.*; *see* Ellis v. Carter, 291 F.2d 270, 273 (9th Cir. 1961) (implying § 10(b) remedy when express remedies available). If the plaintiff is successful in alleging fraud, *see* note 208 *supra*, however, the *McFarland* court's rhetoric indicates that the court will not hesitate to deny an implied right of action under § 10(b). 493 F. Supp. at 655.

In addition to questioning the implication of a private right of action under § 10(b), the *McFarland* court refused to recognize an implied right of action under § 17(a) of the '33 Act. *Id.* at 650. The court reasoned from *Redington* and *Transamerica* that the Supreme Court did not favor inferring any new private rights of action under the securities laws. *Id.*

proaches either fail to apply or misapply the two-part test adopted by the Supreme Court in *Redington* and *Transamerica* for ascertaining whether to imply a private right of action.

The Second Circuit's "nullification" approach in *Ross* focuses primarily on whether the terms of the implied remedy unjustifiably would abrogate the procedural and substantive limitations of the competing express remedy.[219] The "nullification" approach is similar to the Supreme Court's examination of whether implication would be consistent with the Act's overall legislative scheme in ascertaining whether Congress intended to create a private remedy.[220] By focusing solely on this factor, however, the *Ross* court fails to consider two other important indicators of legislative intent, which are the plaintiff's status as an intended beneficiary of the statute and the statute's legislative history.[221] In addition, the Second Circuit's application of its "nullification" approach is flawed. As a concept, "nullification" of a statute occurs when the statute is rendered absolutely void.[222] Because the distinction between voidness and non-voidness may be narrow, a proper "nullification" approach requires a careful section-by-section consideration of the effect of an implied remedy on an express liability provision.[223] In *Ross*, however, the court failed to consider the severe procedural restrictions placed on the express remedies in examining whether an implied remedy would nullify the express provisions.[224]

The *Ross* approach, along with *Wachovia's* "legislative intent" approach, is also incorrect in the degree of veneration it accords to the widespread acceptance of an implied right of action under section 10(b).[225] Both *Ross* and *Wachovia* focus on the present intent of Congress, with the *Ross* court reasoning that the continued acceptance of a section 10(b) remedy indicates congressional approval.[226] The D.C. Circuit goes even further in *Wachovia*, reasoning from Congress' failure to limit or constrict the remedy that Congress must have initially intended to create the private remedy.[227] The concern of both courts with the intent of the current Congress is misguided and irrelevant. In interpreting statutes,

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[219] *See* text accompanying notes 151-52 *supra.*

[220] *See* text accompanying note 128 *supra.*

[221] *See* text accompanying notes 126-27 *supra.*

[222] BLACK'S LAW DICTIONARY 963 (5th ed. 1979); *see* Cox, Ernst & Ernst v. Hochfelder: *A Critique and an Evaluation of Its Impact upon the Scheme of the Federal Securities Laws*, 28 HASTINGS L.J. 569, 607 (1977) [hereinafter cited as Cox] (one or more isolated advantages in § 10(b) action will not nullify express remedies).

[223] *See* text accompanying notes 243-85 *infra.*

[224] *See* 607 F.2d at 556.

[225] The *Ross* and *Wachovia* courts failed to acknowledge the Supreme Court's statement in *Cannon* that the recognition of an implied remedy under § 10(b) was "mere acquiescence." Cannon v. University v. Chicago, 441 U.S. at 692 n.13.

[226] *See* 607 F.2d at 556; text accompanying note 165 *supra.*

[227] *See* [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,712, at 98,731 and 98,736-37; text accompanying notes 192-94 *supra.*

courts should seek to give effect to the legislature's intent at the time of the statute's enactment.[228] The inaction of a subsequent Congress forms a particularly hazardous basis for determining the intent of the enacting Congress.[229]

The Supreme Court's decision in *Piper v. Chris-Craft Industries, Inc.*[230] further indicates that widespread recognition of a section 10(b) remedy does not necessarily mean that courts should uniformly imply a right of action under that section. In *Piper*, the Court held that courts may imply a private right of action under section 14(e) of the '34 Act in favor of tendering shareholders but not in favor of a defeated tender offeror.[231] The selective delineation of a private remedy in *Piper* indicates that recognition of an implied remedy may depend upon the status of the plaintiff.[232] Since the Supreme Court has sanctioned selective implication of private rights of action, lower courts should use the Court's analytical framework to determine whether particular classes of plaintiffs have standing to invoke the section 10(b) remedy.

In attempting to apply the Supreme Court's methodology for ascertaining the intent of the enacting Congress, the *Wachovia* court commits several grievous errors. By finding that the plaintiffs, as investors, are members of the special class for which Congress enacted the statute, the D.C. Circuit failed to consider the Supreme Court's reluctance to imply rights of action under statutes that create general duties for the benefit of the public.[233] The court also erred in searching for a congressional intent to deny a private remedy after failing to find an express congressional intent to create the private right.[234] The Supreme Court indicated in *Transamerica* that if a court can find no express congressional intent to create a private remedy in the legislative history, the court should look for implicit congressional intent in the statute's language, structure, or the circumstances of the statute's enactment.[235] If these sources fail to reveal a congressional intent to imply a private right of action, a court should deny the requested private remedy.[236] Finally, in recogniz-

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[228] Touche Ross & Co. v. Redington, 442 U.S. at 560 n.16; *see* 2A SUTHERLAND, *supra* note 91, at § 45.05. The intent of the current Congress is important only to the extent that Congress may enact an express right of action if it finds judicial denial of an implied remedy unacceptable. *See* Touche Ross & Co. v. Redington, 442 U.S. at 579.

[229] United States v. Price, 361 U.S. 304, 312-13 (1960).

[230] 430 U.S. 1 (1977).

[231] *Id.* at 37-41.

[232] *See 1978-1979 Securities Law Developments: Private Rights of Action*, 36 WASH. & LEE L. REV. 944, 947-48 (1979).

[233] *See* text accompanying notes 102-04 *supra*. The Supreme Court views § 10(b) as creating duties for the benefit of the public at large. Cannon v. University of Chicago, 441 U.S. at 692 n.13.

[234] *See* text accompanying notes 187-88 *supra*.

[235] Transamercia Mortgage Advisors, Inc. v. Lewis, 444 U.S. at 18; *see* text accompanying note 119 *supra*.

[236] 444 U.S. at 18.

ing that remedies in the securities act may freely overlap,[237] the *Wachovia* court ignored the Supreme Court's expressed reluctance to imply a private right of action when an express remedy is or was potentially available.[238]

By employing a radically different methodology and refusing to imply a private right of action under section 10(b), the *McFarland* court's "strict construction" approach is subject to different criticisms than the approaches in *Ross* and *Wachovia*. Unlike other lower courts,[239] the district court in *McFarland* has over-reacted in its response to *Redington* and *Transamerica*.[240] By requiring the plaintiff to prove that Congress clearly intended to provide for multiple remedies,[241] the *McFarland* court established an unnecessarily heavy burden against implication. Many statutes, including section 10(b), have little direct legislative history.[242] Congress seldom will have possessed the foresight to express an intent to provide for cumulative remedies in this scant legislative history.

A careful application of the Supreme Court's methodology for implying a private right of action to section 10(b) is perhaps the best indicator of the inadequacy of the *Ross*, *Wachovia*, and *McFarland* approaches.[243]

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[237] *See* text accompanying note 196 *supra*.

[238] *See* text accompanying notes 133-35 *supra*.

[239] Lower federal courts have continued to recognize an implied private cause of action under § 10(b) in the period since the *Redington* and *Transamerica* decisions. *E.g.*, Martin v. Howard, Weil, Labouisse, Friedricks, Inc., 487 F. Supp. 503, 506 (E.D. La. 1980); *In re* New York City Mun. Sec. Litigation, 87 F.R.D. 572, 575-76 (S.D.N.Y. 1980). The Second Circuit recently followed the traditional *Cort* test in implying a private remedy under the Commodity Exchange Act. *See* Leist v. Simplot, 638 F.2d 283 (2d Cir. 1980), *cert. granted*, 101 S. Ct. 1346 (1981) (recent Supreme Court decisions simply "emphasize that the ultimate touchstone is congressional intent").

[240] The *McFarland* court's preoccupation with following the conservative attitude of the Supreme Court overlooks the fact that in several recent decisions the Court has broadly construed certain sections of the federal securities laws. In these cases, the Court emphasized that congressional intent mandated the broad constructions. *See, e.g.*, Rubin v. United States, 101 S. Ct. 698, 701 (1981) (pledge of securities is "sale" under § 17(a) of '34 Act); Aaron v. SEC, 446 U.S. 680, 695-96 (1980) (negligence standard under § 17(a)(1) of '33 Act); United States v. Naftalin, 441 U.S. 768, 771-79 (1979) (§ 17(a)(1) of '33 Act prohibits fraud against brokers).

[241] *See* text accompanying note 212 *supra*.

[242] *See* Ernst & Ernst v. Hochfelder, 425 U.S. at 202 (Congress spent little time discussing § 10(b)); BROMBERG & LOWENFELS, *supra* note 4, at 7.2 (331) (references to § 10(b) in House of Representatives scarcely would fill a page).

[243] The formulation of the "correct" approach for determining whether to imply a § 10(b) right of action is of immediate significance. *Ross* was the first lower court decision in the post-*Redington/Transamerica* era to consider implication of a private right of action under § 10(b) when the defendant's conduct was actionable under an express remedy. Commentators generally have criticized the *Ross* decision. *E.g.*, Higgins, *supra* note 60, at 781-83; Note, *Rule 10b-5: The Circuits Debate the Exclusivity of Remedies, the Purchaser-Seller Requirement, and Constructive Deception*, 37 WASH. & LEE L. REV. 877, 877-88 (1980). *But see* Hazen, *Corporate Mismanagement and the Federal Securities Act's Antifraud Provisons: A Familiar Path with Some New Detours*, 20 B.C. L. REV. 819, 857-58 (1979). The

The Court's legislative intent test militates against implication of a section 10(b) cause of action in cases involving conduct proscribed by any of the express remedies of the '33 or '34 Act. Section 10(b) does not create a distinct federal right in a class of plaintiffs.[244] The legislative history of section 10(b) further indicates that Congress did not intend that an implied remedy under section 10(b) extend to conduct proscribed by express remedies.[245] Congress enacted section 10(b) for the express purpose of providing the SEC with the authority to enjoin manipulative and deceptive conduct not otherwise prohibited by the '33 or '34 Act.[246] Consequently, the legislative history of the '34 Act suggests that the conduct proscribed in the express liability provisions of the securities acts is beyond the reach of section 10(b).[247]

The final consideration in the legislative intent analysis is whether implication of a private remedy is consistent with the overall legislative scheme of the statute.[248] The Supreme Court has indicated that an implied remedy which is significantly broader than an applicable express remedy is inconsistent with the legislative scheme of the '34 Act.[249] A proper analysis of the implication question therefore requires a comparison between the implied section 10(b) remedy and the express liability sections. Courts should discourage implication when the implied remedy is more attractive than the available express remedy, rather than requiring that the implied remedy absolutely nullify the express remedy.

In comparing the section 10(b) remedy to the express liability provisions, courts should be particularly sensitive to the deterrent values of three elements: the plaintiff's burden of proving scienter under section 10(b), and the restrictive limitations period and bonding requirements of the express remedies. Courts frequently have overestimated the difficulty of showing scienter under section 10(b) and underestimated the express remedies' limitations.

The plaintiff's burden of alleging scienter does not significantly restrict the potential use of section 10(b).[250] Some courts allow plaintiffs

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Sixth Circuit has, however, recognized the *Ross* "nullification" approach. *See* Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 429 n.6 (6th Cir. 1980) (dicta). Following *Ross* and *Wachovia*, the Fifth Circuit has most recently held that a cause of action exists under § 10(b) even when the deceit on which it is based is actionable under the express remedy provisions of the securities laws. *See* Huddleston v. Herman & MacLean, 640 F.2d 534 (5th Cir. 1981).

[244] Investors are clearly one of the prime beneficiaries of § 10(b). S. REP. No. 792, 73d Cong., 2d Sess. 3 (1934); H.R. REP. No. 1383, 73d Cong., 2d Sess. 10 (1934); *see* text accompanying note 164 *supra*. Because of the large size of the investor class, however, § 10(b) effectively creates duties on the part of persons for the benefit of the public at large. *See* note 233 *supra*.

[245] *See* text accompanying notes 68-70 *supra*.

[246] *See* text accompanying notes 69-70 *supra*.

[247] *See* Ruder, *supra* note 70, at 659.

[248] *See* text accompanying note 128 *supra*.

[249] *See* Touche Ross & Co. v. Redington, 442 U.S. at 573-74.

[250] Valente v. Pepsico, Inc., 454 F. Supp. 1228, 1251 (D. Del. 1978); Pearlstein v. Justice Mortgage Advisers, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,760, at 94,977 (N.D.

limited discovery in order to develop more fully their scienter allegations.[251] All courts liberally grant leave to replead,[252] thus allowing plaintiffs to gather additional facts through informal or state law means.[253] In addition, courts merely require an allegation of "some element of scienter,"[254] which a plaintiff may satisfy by showing reckless conduct by the defendant.[255] Under this standard, the scienter requirement is no more difficult to satisfy than the good faith defenses available in several express remedies.[256] Finally, a plaintiff may find that scienter is not invariably more difficult to prove than negligence.[257]

In comparing the desirability of the section 10(b) remedy to an express remedy, courts often overlook the advantages inherent in the section 10(b) limitations period. Congress' failure to supply an express statute of limitations provision for section 10(b) affords a plaintiff several distinct advantages. The adoption of a state limitations period generally gives the section 10(b) plaintiff more time to discover a violation and bring an action.[258] The federal tolling doctrine may further extend the section 10(b) filing period.[259] Finally, because section 10(b) does not contain a statute of limitations provision, a plaintiff proceeding under that section will not have to plead and prove compliance with the statute of limitations.[260] Given the determinative nature of a limitations period,[261] a plaintiff may find the foregoing advantages important in electing to pursue a section 10(b) claim when the defendant's conduct might have been actionable under an express remedy.[262]

Tex. 1978); Patrick, *The Impact of* Ernst & Ernst v. Hochfelder: *Pleading with Particularity*, 8 INST. SEC. REG. 380, 383 (1977) [hereinafter cited as *Pleading with Particularity*]; *Express Remedy, supra* note 43, at 856-57.

[251] Bishop v. Sklar, Civ. No. 75-H-618-5 (N.D. Ala. 1975). *Contra*, Segan v. Dreyfus Corp., 513 F.2d 695, 696 (2d Cir. 1975).

[252] *See generally* 2A MOORE'S FEDERAL PRACTICE ¶ 9.03, at 9-25, -39 (3d rev. ed. 1979).

[253] *See Pleading with Particularity, supra* note 250, at 384.

[254] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976).

[255] *See* note 73 *supra.*

[256] *See* text accompanying notes 280-82 *infra.*

[257] *See* Note, *Prospectus Liability and Rule 10b-5: A Sequel to* Barchris, 1971 DUKE L.J. 559, 564 n.20 (citing ease of proving scienter, and difficulty of proving negligence, when defendant went through motion of exercising due care in making statement but did so with foreknowledge that statement would be misleading).

[258] *See* 1 BROMBERG & LOWENFELS, *supra* note 4, § 2.5(1); 5 JACOBS, *supra* note 30, § 235-03; note 78 *supra.*

[259] *See* note 78 *supra.* The federal tolling doctrine cannot extend the three-year period of limitations for the express remedies of the '33 and '34 Acts. Turner v. First Wis. Mortgage Trust, 454 F. Supp. 899, 911 (E.D. Wis. 1978).

[260] Jacobson v. Peat, Marwick, Mitchell & Co., 445 F. Supp. 518, 525-56 (S.D.N.Y. 1977). While the § 10(b) plaintiff must prove that his conduct satisfies the federal tolling doctrine, many courts do not require him to assert his due diligence or to set forth the time of discovery of the fraud in his complaint. Jacobs, *Affirmative Defenses to Securities Exchange Act Rule 10b-5 Actions*, 61 CORNELL L. REV. 857, 879 (1976).

[261] Statutes of limitations may thwart liability under a statute, rather than merely making an action under the statute less desirable. *See* JACOBS, *supra* note 30, § 234.

[262] Because of § 10(b)'s adoption of state statutes of limitations and the section's broad

A plaintiff may also choose to proceed under section 10(b) to avoid the potential imposition of security for costs and attorneys' fees under the express remedies.[263] Statutes imposing security for expenses are insurmountable for many plaintiffs.[264] Because the courts' power to impose costs under an express remedy is discretionary, a plaintiff proceeding under one of those sections has no assurance that his good faith conduct will protect him.[265] If a court imposes security for costs, the plaintiff has no right to appeal the court's decision.[266]

In addition to the restrictive statute of limitations and cost assessment provisions, other elements and defenses of sections 11 and 12 of the '33 Act discourage plaintiffs from bringing actions under those sections.[267] Congress specifically limited the right to bring an action to purchasers under section 11 and to those persons having claims against their immediate sellers in section 12.[268] A potential plaintiff falling within one of these narrow classifications may further hesitate before proceeding, because of the rejuvenated status of the "due diligence" and "reasonable care" defenses of sections 11 and 12(2).[269]

Finally, potential plaintiffs may decline to bring an action under sections 11 and 12 because of these sections' limitations on damage awards. The circumscribed damages available under sections 11 and 12 reflect Congress' primary intent that the sections deter illicit conduct, rather than compensate harmed investors.[270] The damage-limiting causation provision of section 11 further restricts the usefulness of that remedy in time periods involving a decline in the market price of all stocks.[271] In contrast to the section 11 and 12 remedies, the implied nature of a section 10(b) action accounts for great judicial flexibility in assessing

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broad venue provisions, *see* note 79 *supra*, § 10(b) actions also may foster forum shopping. Higgins, *supra* note 59, at 784; *cf.* Note, *Limitation Borrowing in Federal Courts*, 77 MICH. L. REV. 1127, 1139-40 (1979) (state borrowing statutes may limit forum shopping under § 10(b)).

[263] *See* notes 26, 51, and 80 *supra*.

[264] 1 BROMBERG & LOWENFELS, *supra* note 4, § 2.5(e). Congress enacted the provisions regarding security costs for the purpose of deterring suits. *See* note 26 *supra*.

[265] 3 LOSS, *supra* note 8, at 1841.

[266] Klein v. Adams & Peck, 436 F.2d 337, 338-39 (2d Cir. 1971). A district court's imposition of costs is not appealable because it is not a final order and seldom could constitute an abuse of discretion. *Id.*

[267] Despite the disadvantages of §§ 11 and 12, Congress' imposition of the burden of proof on the defendant in actions under those sections would appear to make the sections more attractive to a plaintiff than § 10(b). *See* notes 16 and 31 *supra*. Courts have tempered this advantage, however, by refusing to grant motions to dismiss under § 10(b) prior to discovery. *E.g.*, White v. Abrams, 495 F.2d 724, 729-30 (9th Cir. 1974); *see* Cox, *supra* note 222, at 603-04.

[268] *See* text accompanying notes 19 and 32 *supra*.

[269] *See* text accompanying notes 21 and 35 *supra*.

[270] *See* text accompanying note 11 *supra*.

[271] *See* text accompanying note 23 *supra*.

damage awards.[272] Decisions granting plaintiffs compensation under section 10(b) in the amount by which their actual damages exceed their recovery under the '33 Act emphasize the expansive potential of a section 10(b) remedy.[273]

The remedies available under sections 9(e) and 18[274] of the '34 Act also are significantly narrower than the implied section 10(b) remedy.[275] Section 18 requires a plaintiff to establish reliance on the actual report which contains the misstatement or omission.[276] Because of this stringent reliance requirement, only the diligent few who read corporate reports can assert a claim under section 18.[277] In addition, section 9(e)'s willfulness requirement[278] and section 18's "good faith" defense[279] are the practical equivalents of a scienter requirement. The section 9(e) plaintiff's burden of proving the defendant's willful manipulation appears to equal the Court's liberal section 10(b) requirement of proof of "some element of scienter."[280] Although the defendant has the burden of proving his good faith under section 18, courts and commentators have equated this "good faith" defense with the scienter requirement of section 10(b).[281] Both sections 9(e) and 18 appear to preclude liability for recklessness, which most courts have found sufficient for liability under section 10(b).[282] In addition

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[272] *See* note 77 *supra.*

[273] *E.g.*, Foster v. Financial Tech. Inc., 517 F.2d 1068, 1072 (9th Cir. 1975); Beecher v. Able, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,303, at 98,534 (S.D.N.Y. 1975); *see Measure of Damages, supra* note 77, at 1165.

[274] Courts and commentators recently have recognized the limited scope of the § 18 remedy and concluded that the remedy precludes an implied cause of action under § 10(b). *E.g.*, McKee v. Federal's Inc., [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,958, at 96,023 (E.D. Mich. 1979); Pearlstein v. Justice Mortgage Investors, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,760, at 94,974-76 (N.D. Tex. 1978); Berman v. Richford Indus., Inc., [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,518, at 94,013 (S.D.N.Y. 1978); Kulchok v. Government Employees Ins. Co., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,002, at 91,512 (D.D.C. 1977). *See generally* Higgins, *supra* note 59; *Toothless Tiger, supra* note 60; *Express Remedy, supra* note 43.

[275] *See* text accompanying notes 276-85. In contrast to the other express remedies of the '34 Act, § 16(b) may actually be more advantageous to a plaintiff than § 10(b). The section contains no scienter-like defense or procedural requirement other than a two-year statute of limitations. 15 U.S.C. § 78p(b) (1976). Section 16(b) does, however, limit the plaintiff class to those suing on behalf of the issuer. *Id.; see* text accompanying notes 51-56 *supra. See generally* JACOBS, *supra* note 30, § 3.02[g].

[276] *See* note 61 *supra.*

[277] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 745 (1975); *Toothless Tiger, supra* note 60, at 116. Most investors never see, much less read, corporate reports. *See* Cohen, *supra* note 43, at 1359-60.

[278] *See* text accompanying note 46 *supra.*

[279] *See* text accompanying note 63 *supra.*

[280] *See* Ernst & Ernst v. Hochfelder, 425 U.S. at 201; note 73 *supra.*

[281] *E.g.*, Pearlstein v. Justice Mortgage Investors, [1979 Transfer Binder] FED. SEC. L. REP (CCH) ¶ 96,760, at 94,975 (citing Ernst & Ernst v. Hochfelder, 425 U.S. at 211 n.31).

[282] Higgins, *supra* note 59, at 787; *see* note 73 *supra.*

to restrictive limitations periods,[283] bonding requirements,[284] and limited damage awards similar to those under the '33 Act,[285] the foregoing elements have discouraged plaintiffs from proceeding under sections 9(e) and 18 of the '34 Act.

Thus, a private action under section 10(b) is significantly more attractive to potential plaintiffs than the express remedies of the '33 and '34 Acts.[286] Application of the Supreme Court's legislative intent analysis indicates that Congress intended the express remedies to be exclusive. In addition to the restrictiveness of the express remedies, the care by which Congress developed the express liability provisions evidences its desire that the remedies be exclusive. The express remedies of the '33 and '34 Acts reflect the meticulous drafting, compromises, and amendments of a Congress expressly concerned with the potentially volatile effects of its actions on the securities industry. Recognizing this manifest legislative intent, the proper judicial approach must refuse implication of a private right of action under section 10(b) whenever the defendant's conduct violates an express liability provision. Only through the use of such an approach may a court accommodate both the intent of the enacting Congress and the established judicial recognition that a private right of action may lie under section 10(b).

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[283] *See* text accompanying notes 49 and 65 *supra*.

[284] *See* text accompanying notes 50 and 66 *supra*.

[285] *See* text accompanying notes 48 and 64 *supra*.

[286] The implied § 10(b) remedy has produced significantly more litigation than the express liability provisions. *See, e.g.*, SEC v. National Secs., Inc., 393 U.S. 453, 465 (1969) (§ 10(b) may be most litigated provision in federal securities law); 1 BROMBERG & LOWENFELS, *supra* note 4, § 2.4(1)(a) (§ 10(b) generates several times as much litigation as express remedies); *Causation of Damages*, *supra* note 23, at 227 (only 11 reported recoveries under § 11 between 1933 and 1976).